STOCK MOVEMENTS AND SPECULATION

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BY

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PREFACE TO THE FIRST EDITION

It was a remark of the great English financial writer Walter Bagehot that in the stock market, and there only, the "economic man," actuated solely by the desire for gain, ceases to be a convenient fiction and becomes a reality. Everyone concerned buys or sells to make money or to conserve it. Considered in this way, the problem of stock market fluctuations appears as a specialized aspect of psychology in a very specialized field of human endeavor.

The buying and selling in the stock market based on these limited motives and intentions is obviously restricted by the disposable capital of the participants or by the credit they can obtain. Shares of stock are bought on margin with the aid of bank loans made through brokers, or are carried for owners by loans made directly at banks. Without its interrelation with the banking system the American stock market would present a widely different aspect.

As shares are not consumable but may return again and again to market, the relation between the relative number of shares that are ready for sale at or near the current quotations and the number of shares firmly held by owners has an immediate influence on the rapidity and extent of the price movement caused by a given number of transactions. This relation of the floating supply of stock, as it is called, to the fixed quantity constitutes a peculiar feature of the stock market in its decisive conditioning of market movements.

Under the influence of these factors and conditions stock prices move up and down in great surges. Within these

large primary movements characteristic both of the general market and of individual stocks in the market are less extended, secondary movements, which, again, are traversed by still smaller fluctuations, and so on down to minute up-and-down zigzags of a fraction of a point.

Graphs of stock movements exhibit certain differences from diagrams of prices in the bond market, while the differences from the price swings in the produce and cotton markets are striking. The upward surges in the stock market are the expression of speculative foresight. A great rising market, such as that of 1924 onwards, pursues its course under the in-and-out direction of powerful industrial and financial interests operating for the rise, almost always in concerted groups and cliques directed by single managerial minds.

It is otherwise in a definitely falling market. The fall is brought about, not by directed market control, but by pressure. The pyramid of bank loans on which the price structure was built up is toppled over and prices are cast down.

The speculative foresight which adjusts stock prices into some sort of harmony with coming business changes does not exhaust the connection of the stock market with the general business world. Though the investment dealings are small in number compared with speculative, yet investors and semi-investors make up the great majority of the firm, static holders of meritorious shares.

It is the relation of current stock prices to investment returns on stocks that is the usual decisive factor in the banking judgment that shares are or are not deserving of further price appreciation. But this is not all. The financial operations of promotions, mergers, readjustments, receiverships, reorganizations, and foreclosures may strongly reverberate within the stock market, and through the buying and selling induced to retain or seize corporate control may act as powerful levers on the course of stock prices.

PREFACE TO THE FIRST EDITION

As prices move only up or down, the fact that apparently some ninety-eight or ninety-nine speculators out of a hundred habitually lose would seem like a contradiction of the theory of probability. It is not nearly so difficult to take the market reports in a newspaper, make imaginary purchases and sales, and reap a golden but imaginary harvest. But the newspaper speculator has hardly put up actual money within the stock market of reality when he finds his judgment confused, his mind distracted, and his plans torn awry. Few can any longer correlate clear vision with decisive action. The man able to win consistently in the stock market by his personal activities and not merely as passive member of a syndicate is generally built on lines far different from those of the ordinary run of humanity.

The man who operates a complicated machine does so best when he best knows its construction. The present book aims to give the student a scientific knowledge of the factors that alternately enhance and depress stock prices. It also aims to give to those temperamentally capable of consistently successful speculative activities such help as may assist them efficiently to help themselves.

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F. D. B.

PREFACE TO THE SECOND EDITION

The culmination of the greatest bull market in stock exchange history has made it desirable to rewrite the last chapter. It is worth noting that no alteration was found necessary in the concluding section, which stands as previously written.

Various small changes have been made throughout the book, none of sufficient importance to particularize. A careful statement on the meaning of market discount in a bear market has been appended to Chapter IV. The diagrams have been brought up to date where it has seemed desirable. Several new graphs have been inserted or substituted for those previously used.

The acknowledgments to those sources which have permitted reproductions of text and charts are renewed.

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CHAPTER I

STOCKS AND STOCK PRICES

Finance, in its older meaning, was concerned with governmental taxation and the conduct of the exchequer. The development of the corporate form of business in the last seventy-five years has made the word denote more than formerly. Modern finance includes the promotion of the new corporation, the accrediting of the going concern, sometimes its readjustment or reorganization. The stock, or ownership, of a corporation may afford an income to the investor, a profit to the speculator and control to the directory.

Stock is divided into shares which may be all of one sort, as with the New York Central railway stock; or, may be divided into preferred and common, as is the case with most great corporations or may be still further divided as, for example, in the Virginia-Carolina Chemical Corporation. Preferred stock has a prior but limited claim for dividends on the year's earnings and if the company be wound up usually a prior claim on its net assets. Common stock receives its dividends from the fund left after the satisfaction of the claims of the preferred holders. Where there is but one class of stock it has all the rights and duties of ownership.

Previous to the claim of stock against the income of

a corporation lies the claim of the debts, liquid and funded, for interest. In the early days of corporate organization, it was generally customary to let the nominal, or par value, of the preferred stock and funded debt, or bonds, together, represent the actual capital involved in the origination of the corporation. The common stock represented what was thought to be the possibilities of the company. If the company did become prosperous the value of the common stock naturally enhanced and as its price approached par, it was said to have the "water," or hopes of its promoters "squeezed-out," and replaced by more material assets.

In quite recent years, stock without par value has been issued by various good corporations. Instances of this sort of financing may be seen in the shares of American Locomotive, Studebaker and others. No-par shares may be expected to sell around a central figure of $100 whenever the return in number of dollars annually as dividend approximates the dividend rate on the sort of security such shares are supposed to offer.

INVESTMENT AND SPECULATION

Holders of stocks are generally classed as investors and speculators. Stock may, however, be held for purposes of control, and may be considered to fall under either of these classes. The difference between investment and speculation is real but not definitely objective; it depends more on the intentions of the owner. Thus, the investor buys for income, the speculator in hopes of a favorable change in price, but each may change his mind later on. A general factual distinc-

tion is that the investor usually holds his stock for a very much longer time than the speculator, and this distinction is quite sufficient to separate the mass of the two sorts of owners. Between speculation and gambling an identity is sometimes alleged. It is plain that the motives of participants and the element of uncertainty are alike in both; but there is a real economic difference. Gambling, as Emery well says, "consists in placing money on artificially-created risks of some fortuitous event, speculation consists in assuming the inevitable economic risks of changes in value." The distinction is thus not only real but definitely objective.

The distribution of the original stock of a corporation may occur in several ways. Old, established corporations tend more and more to offer new securities directly to their own stockholders who may reasonably be supposed likely to buy into the new issue; the desirability of the new shares is, when possible, very often enhanced by offering them for sale at a figure less than the price of the old shares in the market. It is easy to figure out that, after the distribution of the new shares, each share old and new alike, will have a value, in theory, greater than the offer price of the new stock. If the stockholder who buys into the new issue wants to sell the shares bought he can thus do so at an immediate profit; or his "rights" to do so, as they are called, may usually be readily sold.

STOCK UNDERWRITING

But probably the majority of new stock currently issued is underwritten in the first instance. The under-

writing houses of America are certain great banks, private bankers, foreign exchange dealers, stock exchange members, who undertake the sale of the new securities by a guarantee that if the sale does not eventuate, they will themselves buy them in by a definite date. If the securities are not taken by that date, the individual underwriting concerns have to take up their quota and settle for it. This is the usual, indeed probably invariable, custom at the issuance of new shares of a reorganized corporation. But in promotions, the underwriters' liability may be contingent and their action more like to that of agents. Also, the organization of the underwriters may take the legal form of a syndicate or even one or two sub-syndicates in addition; or it may retain quite a loose form. In the case of great corporations, the legally formed syndicate is usual, often with a sub-syndicate.

The underwriters having the security under their control for the term of the agreement now offer the stock to the public. This offering is made through the newspapers, through the mails by circular letters or by verbal offers to customers. The selling process may have some complicated phases or it may be simple; but, in any event, if the corporation be a large and prosperous concern, the final market will probably be on a stock exchange. Permission will be granted the corporation to "list" its shares and after they are listed, they may be bought and sold on that exchange. It will be noticed that the company does not sell directly to buyers by means of the listing. Nevertheless, till recent years, the stock exchange was the place where those connected with the inception of the company dis-

posed of much of their original holdings. At the present time the great exchanges, such as the New York Stock Exchange, do not readily list shares until they have undergone the preliminary distribution just noted. Part of this primary distribution is frequently attained by listing, previously, the stock on the New York Curb Exchange.

The function of the exchange at the inception of trading in a new company's shares is to afford opportunity for the sponsors of the stock to make an equable market for the security. This process takes place through offers by the underwriters to buy when the price falls and to sell when it rises too fast. To go into the matter further would involve points which must be discussed in detail later. The technical processes are given in full in *The Work of the Stock Exchange*, by its economist, J. Edward Meeker, pp. 438-475.

THE STOCK EXCHANGE

When stock has been so distributed that its customary market is the exchange on which it is listed, its movements and action can be followed with a large degree of certainty. There are various exchanges in the large cities but that of New York is the only one in the first rank; even the Boston Stock Exchange, which used to be regarded as the center of trading in certain mining stocks, has lost much of its importance in the post-war years. On the New York Stock Exchange, memberships, or "seats," are limited to exactly 1375. Members of the exchange occasionally constitute a firm of brokers, but it is far more usual to find a

brokerage house whose partners are nonmembers of the Exchange with one exception. This exceptional partner, the actual member of the New York Stock Exchange, is called the Board member, and he only has customarily the privilege of trading on the floor of the exchange.

The unit of trading on the New York Stock Exchange is a lot of 100 shares of stock. About half a dozen houses, however, specialize in buying or selling "odd lots"—less than a hundred shares—for those customers with small resources or who prefer to trade in a modest way. Stock bought for speculation is bought with the aid, in the first instance, of the broker's funds. The customer puts up about 15 to 20 points of the market price of the stock he buys and this sum is called his margin. Before the war the customary margin was less, only ten points, and in low priced stocks this amount will even now be sometimes accepted as satisfactory by a broker. The stock bought for the customer's account may be repledged by the broker at his bank in order not to deplete or tie-up his own resources too far.

Since May, 1892, stocks in which there is large activity, are "cleared." Each broker makes out a sheet, each full trading day, of his purchases and sales for customers. Suppose he bought 400 Steel and sold 500. Instead of delivering 500 shares to buyers and receiving 400 from sellers, he would simply deliver the balance of 100 shares. More recently, since April, 1920, the monetary balances of the day's purchases and sales are also cleared. By these two processes, an enormous amount of clerical and messenger work and bank

service is dispensed with. The process does not affect the course of stock prices since it annuls no contracts but merely hastens their consummation and it does not affect the ability of a buyer of stock to obtain shares which he ordered bought, if he wants to take up the shares.

A stock which has paid dividends for years and which seems likely to continue to do so, tends to go more and more into investment hands. Stock when bought by an investor is usually registered in his own name on the corporation's books, so that he may receive the dividends directly and without recourse to the broker through whom he bought the shares. As investors grow in number in a company, the average individual holdings necessarily decrease. Thus, the number of stockholders in New York Central rose from 22,532 in 1916 to 40,660 as of December 31, 1925, while the average holdings of each owner fell from 117 shares to 94. Again, in 1913, there were 39,000 registered owners of Steel common while the figures of September 30, 1927, are exactly 97,000. Figures of the same sort and with the same meaning might be given for American corporations generally.

PERCENTAGE OF SPECULATIVE TRANSACTIONS

During any year there is a certain amount of transfer of speculatively held stock from one broker's name to another. According to the rules of the New York Stock Exchange, such stock will be a "good delivery" if, being in the name of a broker, it has his endorsement on the back of the certificate. Or, if being in the

name of a nonmember, it has the registrant's signature on the back and the endorsement of this signature by a broker. But if the certificate be of dividend-paying stock, re-registry causes the dividend to come directly to the last broker holding the stock. In this way it comes about that re-registry includes more than investment transfers—it always includes a certain number of speculative transactions. It is, therefore, not possible to say from the registry figures exactly how much stock is bought in a given time by those who are real investors. Moreover, the figures made public by corporations are generally in the form of the net increase or decrease of stockholders during that period. Nevertheless, if we multiply the net change of stockholders by the average number of shares held by each owner, and divide this product by the transactions in the stock on the New York Exchange we shall get a proportion between a figure which includes all investment changes and a figure showing the total dealings.

When this calculation is applied to various shares it shows that in the active stocks the figure which includes investment transfers is very low in proportion to all transactions. Owing to the fact that the larger the total transactions, the larger the speculative transfers (made for convenience of brokers), it would seem certain that in the active shares the ratio is ultra-conservative. Now, in these shares a little calculation will show that the figures show very extreme ratios—frequently over 99 per cent of all transactions being outside of those reported from the registry books. Hence, taking the active stocks as a whole, it will be very well within the facts to say that over 95 per cent of all

dealings in them on the Exchange are of speculative nature.

BROKERAGE CHARGES

In active stocks, the multitude of daily transactions causes sales constantly to occur at every allowable figure, thus affording a continuous as well as a broad market to buyers and sellers. The smallest fluctuation allowed is 12½ cents per share, or $12.50 per 100 shares. This used to be the commission charged by a broker for buying or selling that amount of stock. But, since the war, the brokerage commission has been raised from this figure of one-eighth of a dollar on any share bought or sold. The rise in the commission rate has deterred, in fact practically stopped, all the many transactions which had for objective merely to sell an eighth or a quarter higher than the purchase price. This process was called "scalping" and had a good deal to do with ensuring the continuity of the range of prices. This important change makes it advisable to note the present range of commissions. They run from stocks selling under $10 a share, $7.50 per 100 shares, by gradations up to shares between par and 200, for which $25 a hundred shares is charged; thence upwards by gradations to stock selling at $350 a share which costs $40 per hundred shares to buy or sell. The minimum commission is $3; it used to be $1.

PUBLIC BENEFITS OF STOCK SPECULATION

Speculation in a stock plainly tends to ensure not only a continuous market, with a close range of varia-

tion but, in all active stocks, an instant market. Speculation keeps good stock in public view and, thereby, helps its investment absorption. To place stock of unknown companies with investment buyers without the intermediation of speculators would sometimes mean a slow process for the original owners of shares and would often involve concessions in price. Even on the Exchange a high class stock which is not "seasoned"—well-known—will sell lower than it would otherwise seem to deserve. During the latter part of 1926 it was computed that there were nearly 200 stocks on the Board which would have netted the buyer 7 per cent or more on his purchase price. Many of these shares were really high class but the speculative interest in them was still small or sporadic outside of the interest of the owners. One hundred and three of these stocks were common, and it is curious to note that somewhat over six months later, or in May 1927, sixteen had risen in price to a figure which returned less than this 7 per cent. They had become more "seasoned."

CHAPTER II

WHY THE MARKET MOVES

The movement of stock prices, up and down, is due to the buying and selling of those in the market. But what are the fundamental reasons that stocks are bought and sold? The answer is, in the words of the late Walter Bagehot, the famous English financial writer, that in the stock market and there only, the fictitious "economic man," actuated solely by cupidity and fear, becomes a living reality. More conservatively stated, it may be said that the motives impelling to action in the market, may, for practical purposes, be reduced to two, the hope of financial increment and the fear of financial loss. The desire of the speculator for gain, of the investor for a large or a safe income, of the large stock owner for control or its retention in a corporation, depend, all three, on these motives.

STOCKS AND COMMODITIES COMPARED

But these motives are conditioned by circumstances. The beliefs, the knowledge and the capital of the participants modify the direction and the extent of their sales or their purchases. Moreover, the nature itself of stocks, as distinct from that of commodities, imposes and implies certain restrictions in connection with their purchase and sale.

Commodities are bought and sold because the final buyer, the consumer, intends to use them. Foods are bought to be used almost at once; furniture and clothing, personal comforts, conveniences and luxuries are bought for longer enjoyment, but, in the end, they, too, will be consumed and other goods acquired to take their place. Even goods destined to long employment, houses, factories, railroads, bridges, canals, steamships, must all in turn pass away, whether through deterioration, dismantling or destruction and other goods of the same sort and, often, bearing the same names, must come in their stead.

But as long as the legal entity, the corporation itself, persists, nothing of this sort is true of stocks. Shares of stock are but the evidence of the business relation of ownership. As relations they are intangible and are dealt with simply through the paper certificates of their existence. Their values fluctuate, of course, with the value of their corporation. An old story, told to novices in Wall Street, may be recalled. A man placed a hundred shares of a good dividend paying stock in a safe deposit vault. There came a time when the stock no longer paid dividends and he decided to take it out of the vault and sell it. But the stock could not be sold because the company had failed and no one wanted its shares. But the former investor could not understand the matter. "How in the world could the value of that stock leak through that vault?" he demanded. But had the stock been goods, had value in use attached to it, the value would not have vanished!

It may seem that the statement that stock prices are

merely the resultant of market action based on hopes and fears of gain and loss, is so plain as to be hardly worth such emphasis. But this is far from correct. One of the gravest impediments to an understanding of price movements is due to the tendency to forget that nothing at all happens in the stock market except through buying and selling, and that all buying and selling is the expression of the two motives referred to.

EFFECTS OF STOCK DIVIDENDS

In considering, later on, a certain section of stockholders existent in probably all corporations of any extent, attention will be drawn to the peculiarly personal motives which lead them to keep a stock once they have bought it. Here we may advert to another example of the influence on market action of the psychological factors on which our attention is just now focussed. When the amount of stock outstanding in a corporation is increased by a stock dividend, it is plain that there has been merely redistribution of the capital rights. Nothing has changed in the company, and common sense would indicate that the price of the new stock added to the price of the old stock ought exactly to equal the former price of the old stock.

Thus, if a 50 per cent dividend is paid in stock and the owner of two shares of stock with a market valuation of $150 each receives from his company one new share, it might be supposed that on receipt of this new share, each of the owner's shares would be worth $100 each, or, the value of the three, $300, should exactly equal the former value of the two old shares, also $300.

But hardly ever does this happen. Practically invariably, the shares after the stock dividend is received sell for above what they might be supposed to bring; in the case before us, the three shares after the payment of the dividend will probably sell for $110 or some such price instead of for $100 each. When the stock issue had, previously, been inconveniently small and the value of each share consequently so high as to make a sale somewhat of a bother, such rise might be explained. This was the case with the old Standard Oil shares which sold at about $600 a piece and paid a 40 per cent dividend. They were a nuisance to sell, though, in this instance, other factors contributed to the difficulty.

But in other cases no such explanation is feasible. We are simply face to face with a mass psychological judgment. Nor do we here take into account that these stock dividends are often accompanied by speculative rises in the price of the shares before the new shares are distributed. The explanation has been offered that, since State legislators are generally supposed hostile to the payment of dividends much higher than the usual rates of interest—there is an unwillingness on the part of investors to buy into a very high-priced stock which pays a very high dividend and that they much prefer that the company should increase the number of shares and pay a lower dividend on each. Whether this consideration makes plain the situation may be a matter for debate. But there is no doubt of the strong subconscious tendency among the market participants, both investors and speculators, to overvalue an increased capitalization, in the prices which they approve.

PARTNERSHIP AND CORPORATE RETURNS

It has been frequently noted that whereas a capitalist, small or large, if buying a business to operate personally, will want to buy at a price which will enable him to make money at rates far in excess of the interest rate; on the other hand, will, when buying investment stock, be content to pay a price which will net not so much more than the interest rate. Thus, a department store merchant will hardly be content with much less than 20 per cent upwards on his capital. But if his store be successful and become afterwards incorporated, the shares will sell on a basis to net the former owner very much more than he could have received at private sale. Particularly is this true if the old owner retains the management in person and holds a certain appreciable percentage of the shares. The purchaser of shares in being relieved of managerial duties and financial responsibility for the business, tacitly agrees to be content with an income return much smaller than the company, if a firm, would return to its partners. In other words, stocks are not regarded by investors as fitted to return partnership profits; rather they are regarded something in the light of safe deposit banks where a steady and safe income may be derived. Attention is called to this matter because of the extraordinary difference in value received when a going concern is sold as a firm and when it is incorporated and its shares sold.

A remarkably clear illustration of the preceding remarks is afforded by the history of the department store of Lit Brothers, Inc., in Philadelphia, from its

inception to the present time. This concern was formerly the firm of S. D. & J. D. Lit. An incorporation was effected in New Jersey in 1900 but the stock was not distributed to the public but was very closely held, till 1905. At that date a reincorporation under the laws of Pennsylvania was brought about with a capitalization of $2,500,000 stock, all of one class. A little less than half the stock was offered to the public at a price which, it was supposed, would net the buyer something rather larger than 7 per cent. annually. Actually, the store was an astonishing success. One dollar yearly, or 10 per cent was paid from the start on the shares ($10 par). During 1916 it became evident that the earnings had so greatly increased that their retention in the business was not satisfactory to the leading stockholders. An extra dividend of $2.50 a share was therefore paid, starting in February, 1917, and this dividend was continued till April, 1922.

Meanwhile, the stock, which was thus on a 35 per cent dividend basis, naturally vastly enhanced in price and the owners were faced on a small scale with all the difficulties real and surmised which stocks paying very high dividends are likely to bring on their holders. In April 1921 a stock dividend of $1,000,000 was declared, thereby increasing the capitalization by 40 per cent. Had this not been issued, it is plain that, to distribute profits, the owners would have had to raise the dividend rate to nearly $5 (50 per cent) annually. Profits, however, kept mounting up and the immense returns on the stock attracted much attention. In the following five years, therefore, another million dollars of stock was issued at par (giving "rights" to the stock-

holders) and two stock dividends were issued, until at the close of 1924, the entire capitalization stood at $10,000,000. The 10 per cent dividend is thus the equivalent of nearly 35 per cent on the $3,500,000 actually paid-in capital. The shares are listed on the Philadelphia Stock Exchange.

THE INVESTMENT "BRAKE"

We have noted that, on the part of the buyers, the stock market is ultimately for investment and for control. Also, that the overwhelmingly speculative character of the mass of transactions ministers to the ends of investors and controlling capitalists by offering a steady, open market with minimum spreads between bid and offer quotations. But this dominant fact that, although the *character* of the market is speculative, its final purposes are investment or for control, implies a much larger influence in the market of the investment factor than is discerned on the surface.

If 5 per cent be assumed as the proper rate of return on a high class railroad stock, the price would be expected to approximate the usual par of $100 a share. Nevertheless, the dip of this price to about 85 or its rise to about 115 would excite no comment. In every year, swings in each stock about its normal investment point are looked for as a part of the ordinary fluctuations in the market. In other words, a stock which is held to be worth a principal to return 5 per cent is expected to fluctuate in its return a half per cent or more on each side of the standard rate. If the stock is deemed rather less trustworthy and a return of 6 per

cent is considered more appropriate a swing between rates of 7 per cent and 5 per cent is not deemed unusual, or, in price, the stock might move from around 80 to around 120.

But suppose a good dividend-paying 5 per cent stock moved beyond 115 to 130 or suppose it dipped beyond 85 down towards 60. In these cases, every one alike, speculators and investors, would deem it probable, in the former case, that the dividend would be increased or some similar good news (in the shape of dollars) would come out for the stockholders; while, in the latter case, they would be inclined to expect serious business difficulties ahead and to surmise that the directors and others close to the corporation were selling their shares before trouble became publicly known. It would be very strange if the company's affairs continued in just the same shape and if either of these wide price variations occurred. There is hence a real investment brake on the swings of the market and we may at once search for the means by which this brake is applied.

A very common opinion is that this brake is applied spontaneously and directly by the investors themselves. When their stock is obviously far too high many sell, and when it descends far too low, many buy it as a bargain. The former part of this view, that investment buyers sell when their shares are far above their reasonable worth is more or less correct. Many investment holders, at times, do do this. But when a stock falls very far, the buyers are not nearly so often investors. Men of an investment turn of mind habitually possess a certain cautiousness which makes them feel,

when a stock sells very low, that not improbably there may be something wrong with the corporation. To buy at such times seems something like wagering their judgment against the judgment of the whole market. At very low prices, the bargain hunters, so much spoken of in newspapers, seem much more of the speculative rather than investment type and in neither case does a close examination of the bottoms of large bear markets show proof of a decisive or even particularly important influence emanating from these outside sources.

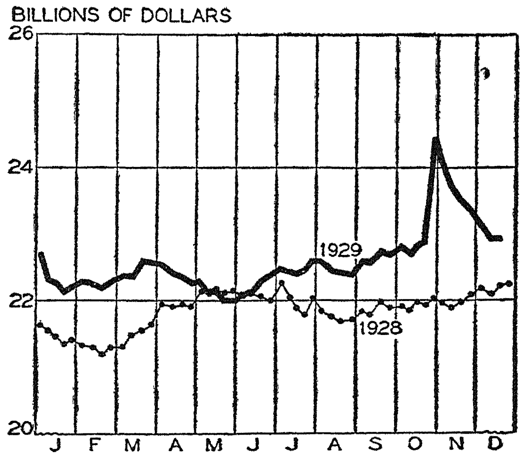
Experience confirms this view. Stocks with no speculative market worth notice receive little or no market support from the investment owners. As a stock in this situation is not usually a prominent security, it is not easy to give an example which is clearly illustrative of this point and not masked by other features. However, one good example may be given. Late in 1914, the shares of a well-known public utility were driven down violently by bearish selling from a previously obscure source conjoined with deliberate bear advertisements which appeared in prominent newspaper columns. The stock was on the old "curb market," as the heterogeneous medley of brokers and adventurers who congregated at that time in front of the Broad Exchange building, was known. This stock was widely distributed among investors, as was evident from its stock lists (which the present writer saw at the time).

What had happened was this: the policy and the management of this corporation were not well liked in very influential quarters and its extensions were deemed unwise. Concomitantly with the drive in the

curb market, a well-known trust company called a loan of a quarter of a million. The corporation, which had not expected the call, took up the loan only by the utmost use of the directors' personal liquid resources. The next day, the trust company called up an officer of the company and politely offered a half million loan. Needless to say, the offer was declined. A general idea of what was going on came, about this time, to some of the more influential stockholders. It does not appear that any of them offered market support to the price, but some made remonstrances against the policy of the concern and the directory agreed to adopt at once a more conservative course. Under these circumstances, the special banking pressure was silently withdrawn and the stock price to some extent righted itself.

BANKS, THE ULTIMATE MARKET STABILIZERS

It thus appears certain that the investment brake on the stock market is not applied to any extent worth while by the investors themselves. But if we reflect that an enormous mass of stock, both investment and speculative, carries bank loans against it, not only from National banks, but from State banks and trust companies, we see at once that it is to the prime interest of the American banking system that stocks should not go too high and that, on the other hand, they should not go too low. The banking relations with the stock market and the exact manner in which this investment brake is applied will be taken up in detail in a later chapter. Here the point must be stressed that the banks are the ultimate stabilizers of American



TOTAL LOANS AND INVESTMENTS OF WEEKLY REPORTING MEMBER BANKS AS OF EACH WEDNESDAY, 1928-1929

corporation stock prices, particularly when prices soar too high or when, as in the panic of 1907 or at times of acute falls, such as the early part of 1926, they dip too low. The protection, such as it is, afforded by short covering at such times will be noted when discussing the swings of the market in general.

THE THREE FACTORS OF PRICE MOVEMENTS

Stock prices may thus be regarded as the resultant of three general factors: there is, first, the psychological factor of the hopes and fears of the participants conjoined with the capital which they are financially able to move. Secondly, there is the relation of the banks to the market, and this relation, as will be seen, not only

limits in general the extent of price swings from the presumed investment point but it makes possible these speculative swings themselves by the extension and withdrawal of credit. Finally, we have to consider the third factor, the manner in which at a given time, the shares of a company are actually distributed and held in the market.

The first of these points has been dwelt on in this chapter sufficiently to give a general idea of its significance. It will be discussed in connection with speculative losses and gains, more at length. The other two factors are concerned particularly with the fact that the market not only moves but that it moves for short to long periods very much in the same direction and very much as a unit. Also, its movements may precede, or "discount" as it is called, the business success or loss of the corporations whose stocks are in question. Why the market should at times make this discount and why its movement should be in waves, short and long, are points which must be noted before more closely examining the other two factors referred to.

CHAPTER III

THE TREND AND THE MARKET DISCOUNT

The trend of the market at any time is the direction, up or down, which characterizes the trading. It is a commonplace in Wall Street to say that the trend of the market discounts the future,—meaning that an upward movement in stocks is prior in time to an upward movement in the business condition of the corporations whose stocks are dealt in. Moreover, the expression which is thus applied to groups of stocks is also applied frequently to single stocks when their decided trend up or down is surmised to express future prosperity or future disaster for the corporation concerned. Now as all movements whatever in the stock market are caused by buying and selling and by nothing else whatever, we must ask whence the buying or selling which at any time produces the trend and we must further inquire why the trend—the present movement of prices—discounts or anticipates the business movement and to just what extent it may be said actually to do so.

With the exception of the professional floor traders who are members of the New York Stock Exchange and whose number is now supposed to be little more than forty or fifty, all other principals necessarily act through a member of the Board as broker. We shall notice situations later on where stock exchange firms, as members, for instance, of syndicates, may be in the

temporary position of principals. The business of a broker however is to execute orders on commission and it is with this main part of the brokerage business that we are here concerned. These "commission houses," as they are called, comprise the immense majority of the number of exchange firms and their name derives from the fact that they habitually execute speculative orders on commission. The houses which deal mostly with investments or which strive to do so are generally called investment houses, though, of course, their profits, also, may derive from commissions.

The commission houses have often branch offices in parts of New York outside of the financial district and many of them have also out-of-town branches. There is no large city or prominent watering place in America where it is not possible to deal on the New York Stock Exchange over a member's private wires to the New York house, with practically as much ease and celerity (unless the wires are down) as in New York City itself. The great majority of customers in these houses trade on the movement of prices as shown on the blackboard or ticker in the firm's office. Wealthy traders, however, are more likely to transmit their orders over the telephone, often by a direct special wire or by personal interview with members of the firm. This wealthier clientele consists generally of professionals, of men of large means but who are nevertheless not regularly in the market, of banks, trust companies, and capitalists interested in the securities of their corporation. A better division, however, can be made by considering the mode of action of all market participants and this we shall attempt when dis-

cussing market control. For our present purposes the above summary enumeration is sufficient.

THE PUBLIC BUYS FOR TWO REASONS

Now there are a few definite things which are known about the mass of customers who are to be found in the offices of commission houses. The main point is that their number increases as the stock market advances and as the public through the newspapers begin to hear of the possibility of "making money" as "stocks are going up." The other fact is that there are practically but two reasons why these traders buy stocks: first, because the stocks are plainly and distinctly going up in front of their faces and they decide to "get on board" for "a good thing." The other reason is that some one has firmly told them so, either from information bureau, market letter or similar source or by direct verbal tip. As we shall see, it is not true, as many outside cynics insist, that a tip is always and necessarily fallacious. We shall go into this fully later on (p. 108). But here all we want to emphasize is that, whether they take tips or act on the obvious course of prices as shown by ticker or blackboard, the public do not make the trend of the market. They follow it.

But neither does the small select group of professional floor traders nor of professional speculators off the exchange, make the trend. All of these men are alert to discern and follow the trend but the very fact that they are so ready to seize and use the character of the course of prices, is, in itself, a statement that they do not make this course.

It might be thought that since neither public nor professionals make the trend of the market, the investors must surely do so. But experience and observation show that investors, buying with the idea of security in their minds, are not very apt to buy when prices are declining, as further shrinkage in marketable values may obtain. Further, we have already shown the extreme smallness of investment to speculative buying in the stock market. The amount of stock which within a given period is bought for investment and the number of the investors who buy this stock are two figures whose ratio is not constant and whose variations seem to follow different courses in the stock of different corporations. It may, however, be said that as a stock passes from speculative into investment hands in the course of years, the number of registered holders increases in number while the average number of shares held by each decreases. But since the speculative holdings were, previously, in the names of brokerage houses, this fact by itself does not lead very far.

As far as can be discerned, investment buying is most in evidence in the market when prices have about completed a long rise but when the market is still steady and, in spots, quite strong. Moreover, the reader must keep carefully in mind that the stocks whose shares furnish immense turnovers are almost always common stocks except where the corporation has but one class of stock. Now common stock practically never is a speculative and an investment favorite at one and the same time. Indeed, this possibility almost implies a contradiction, since investors want stability and speculators want movement. Hence, whether the lead-

ing stocks pay dividends or not, the trend in these stocks is not made by the investment buying which does not appear till they have advanced in prices and whose volume is always very much less indeed than the volume of speculative trading.

MAKING THE TREND

Now since neither the speculators who follow the trend, nor the investors, create this trend, the only conclusion is that the upward trend must be made by those whose upward commitments are made when the market is near its bottom or is at rest. The downward trend is made in an entirely different way: it is forced, as we shall see in detail (see Chapter IV, The Swings of the Market). In other words, those who make the upward trend are those who buy low. Now who are these purchasers? Let us first say summarily that they are not the investment bargain hunters who according to the newspapers appear when stocks are very low and who buy outright and put the certificates into strong boxes whence they issue years afterwards to be sold at great profits. That shrewd business men who are not even semi-professionals do to some extent buy on the definite fact that a stock may be much below its obvious investment value—there is no doubt. But the mass of these purchases is not only relatively small but it is *definite*,—this sort of buying happens and is over. But the buying which makes the trend continues, since the trend continues. Plainly we must look elsewhere to find those commitments which decisively control the direction of price movements.

Now we have seen that it is a maxim that the trend of general stock prices anticipates the future. Hence the commitments which make the trend must be the commitments of those who correctly anticipate the future at least in a general broad way. But those who can do this are plainly the great industrial, commercial and financial capitalists of America. These are the very men who make the decisive trend of the stock movements on the New York Stock Exchange. How the banks are involved in the upward movement of prices, how the buying which advances the price of a stock is conducted and under whose oversight are questions which we shall examine in detail. But our purpose here is merely to indicate the general identity of the great market participants without regard at the moment to just how they do actually participate.

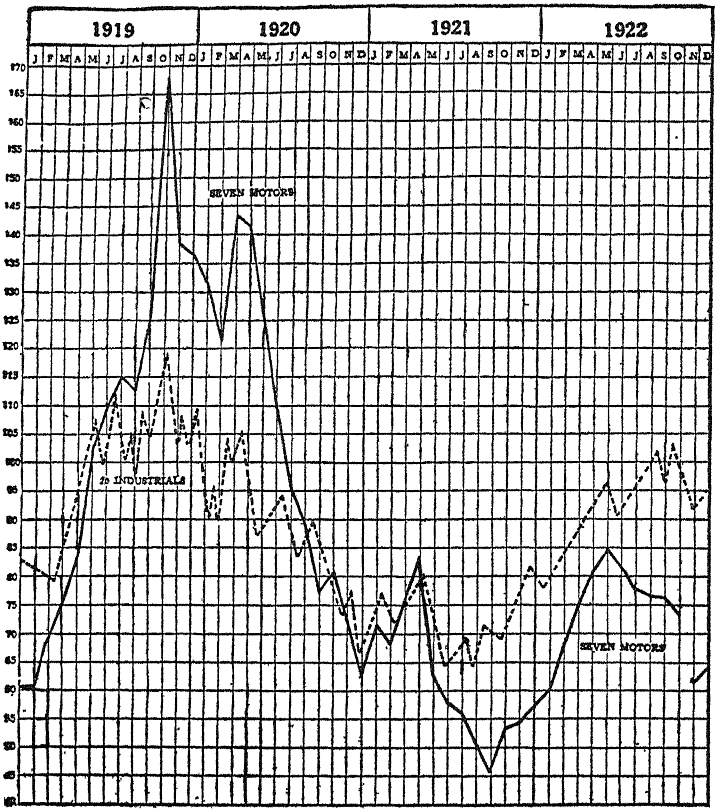
After a business slack, we generally find that buyers and sellers of commodities are more or less out of touch with one another. The producer has no longer a ready market because the consumer has all he will take at the producers' prices. There is a period of what Adam Smith called the "higgling" of the commodity market, and this period has its events complicated by the distance in our country between producer and ultimate consumer, the intervention of various merchants and middlemen. Resumption of business after a depression first exhibits itself in a demand from the greatest wholesale consumers, those whose orders can command new production. Such wholesale buyers are, first of all, the great steel and copper industries.

Large corporate interests and their circles can discern far better than any one else the probable expansion or

contraction of the activities of their industries. In lesser degree, the same remark holds in regard to the business prosperity or adversity of the individual important corporation. So true is this in the steel industry that, for nearly thirty-five years, an advance of moment in the stock market has been a precursor of a great revival in the industry. It has been found that this revival is well exhibited by a consideration of the number of blast furnaces in blast. The concomitance between the two sets of facts is so striking that efforts have been made to use the connection as a guide to speculation. This cannot, however, be done successfully because the market discounts the blast furnace situation and not vice versa.

THE DISCOUNT OF BUSINESS

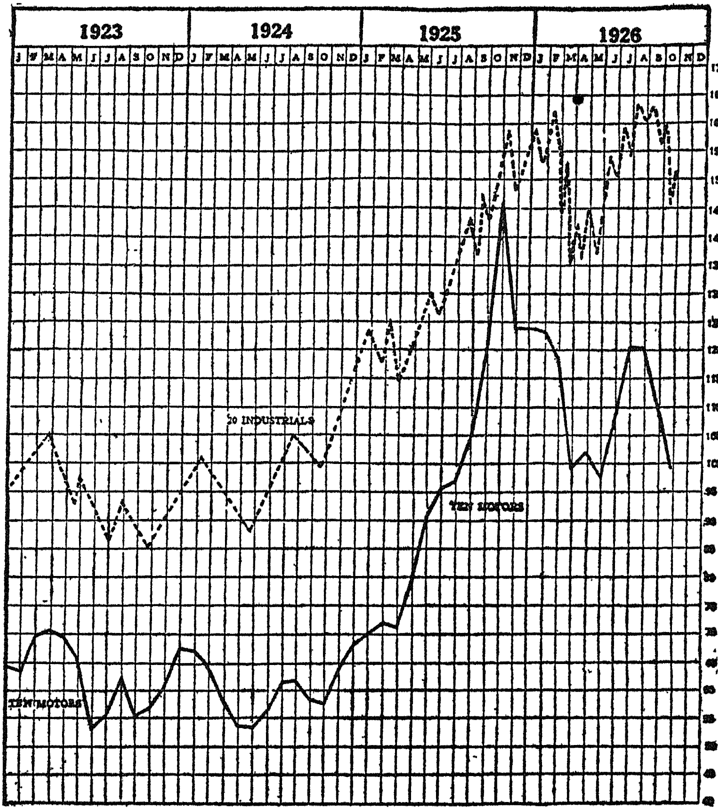
It must be plain that any one who can foresee correctly the course of a business revival can safely buy stocks, certain that the most powerful interests in America are about to take the same view. The trouble is that the small man can rarely make such forecasts with any certainty if he attempt the task in a direct way. Yet he can discern when the business situation is generally gloomy or depressed, when bank credits are easily obtainable and when investment values are considered too low. If he buy at such times, for a long pull, he may at least do so with a good degree of safety. Nevertheless, the exclusion, by the establishment of the Federal Reserve System, of some of the main causes of recurring financial crashes and their ensuing disastrous effect on business prosperity—has made the



THE DOW-JONES INDUSTRIAL AVERAGES AND THE AVERAGES OF SEVEN MOTORS, 1919 TO 1922

discount of the market by the direction of prices not so sure a matter as it was previously. We must examine this discount of general business conditions by the status of the market somewhat more closely.

Between 1900 and 1910 a comparison of United States bank clearings with the course of the stock mar-



THE DOW-JONES INDUSTRIAL AVERAGES AND THE AVERAGES OF TEN MOTORS, 1923 TO 1926

ket will show a very good general anticipation by the movement, of the swellings of clearings. If the New York bank clearings, which include financial deposit-shifting from loans themselves financial in character, be excluded, the priority of stock prices to the volume of the clearings would be even more clearly exhibited.

Also, for the same years, the comparison of railway gross earnings with the course of prices tells the same tale. But the reader should notice that these discounts of the future are obvious and unmistakable only of the great primary movements of stock prices; the discount of the future in detail cannot be followed with exactitude into more limited movements of share prices. But in the years referred to, the priority of stock prices to business is plain. It was the expression of speculative foresight backed by speculative buying.

The interference with business of various factors connected with the recent war, makes a wartime comparison of business and market facts uncertain and unreliable. Let us turn to the post-war period, since 1919, and examine the correlation, whatever it may turn out to be, in these current years.

The relation between stock prices and bank clearings is best illustrated by leaving New York bank clearings entirely aside. When this is done, the statistics show a peak of clearings in May, 1923, following the great stock market peak of October, 1922. A preceding high peak of clearings in January, 1920, followed the market peak in October, 1919. Railroad gross earnings since the war are not so readily compared with stock market movements as formerly. The tables are plainly useless till the roads were at least a year out of the Government's hands. But even since, the constant supervision of the Interstate Commerce Commission interferes with the play of economic competition so firmly as to make comparisons suspicious. However, the relation between bank clearings and market movements up to the last few years is sufficiently marked.

In a bear market the meaning of a discount of future business is not so exact. For instance, the great bear market of 1903 discounted no particular business fall at all. Those liquidating, liquidate because they must. Hence, a bear market does not decisively turn upwards till liquidation has ceased, no matter what intervening rests or rallies may occur, and no matter what premature attempts at bulling may be made.

When from the general business situation we turn to special industries, the lack of correlation between market rises and business conditions may be quite marked. If the reader will consider the chart showing the upward movement of ten representative motor stocks to their peak in October-November, 1925, he will find no discount of a correspondent vast improvement in the business of each corporation represented. Some of the sponsors of this variegated movement simply took advantage of the general rise in the market to hoist their own securities in price and dispose of them at ridiculous figures to the enthusiastic public buyers.

The 1929-1930 situation is discussed in the last chapter.

CHAPTER IV

THE SWINGS OF THE MARKET

A careful examination by many observers during the last quarter of a century has produced an agreement in regard to the character of the up and down movements which are so evident in the market. These movements may, with fair exactitude, be divided into three classes, known as primary, secondary and tertiary swings, and these three sorts of swings occur in both bull and bear markets. By referring to the diagrams in the frontispiece the reader may easily check up the existence and nature of these up and down movements. This classification is often called "Dow's Theory" from the late Charles H. Dow.

There is, first of all, the long primary swing. Let us give our attention to the recent great bull market. The general market began to rise (after the seesaw following the bear market of 1919 to 1920) in August, 1921, and continued its upward course to September, 1922. From that time there followed nearly two years of a seesaw market during which period prices moved within an average limit of about fifteen points. In June, 1924, the market started upwards in earnest though the character of the rise was not clear for a month or two, at that time. From then till the close of August, 1929, the market was a bull market with one very great reaction.

On examining this long movement, the observer will note that its course is composed of zigzag secondary movements ranging in extent from a few points to some fifteen points and more. These secondary movements may cover a period from a week to several months. Within these secondaries, are the still smaller swings of a day or of several days' duration. Even smaller fluctuations might be noted in the tertiary movements, were it worth while to do so.

Let us now fix our attention more closely, on the details of the bull market we are considering. It will be noted that the first secondary swing within this market carried the industrial averages which we are considering, to 105 in August, 1924. Then followed another secondary movement but this movement was a reaction, and it carried prices just below par in October, 1924. There followed an unusually long secondary swell of approximately 25 points and prices rose to nearly 125 in January, 1925. At that point a rest followed,—a short seesaw intervened—characterized by two up-and-down movements of about five to ten points.

CHARACTERISTICS OF BULL MOVEMENTS

In May, 1925 the general market was again back to the January figure of 125. Through this figure it shot without pause and went straight on to 130 where a quite slight reaction in extent but lasting a large part of June, 1925 took place. The reader can readily, for himself continue the remainder of the observation or as much as he cares to pursue. The following facts, however, are already clear; the great upward move-

ment persisting during all these years, has been marked out into a series of secondary zigzags up and down. When the extent of the up-zigzag is about equal over a long period to the extent of the down-zigzag, we have the seesawing market existing between September, 1922, and June, 1924. When the average length of the upward zigzag exceeded the average length of the downward zigzag within a given period, the market, of course, was moving upwards. Or, in other words, in a bull movement, the usual upward secondary swing which is a bulge necessarily covers a wider price spread than does the secondary swing within the same period which is a reaction. It is usually stated that the reaction is about one-half to three-quarters of the bulge, but on examining the diagram the reader will see that this is true only in a rather general way.

At the close of February, 1926, and the beginning of March occurred a great downward dip of nearly 20 points. A smart recovery ensued, followed by a pause and then a slow upward movement for about a week; then followed another pause in mid-March and another downward movement which quickened as it went and which carried prices down to the average figure of 135. Then came a seesaw till late in May when the bull market was resumed and in August slightly overtopped the February rise to over 160. Another downward movement carried prices during October to about 145. In this period from February to October, the reader will have some trouble in deciding what swing should be called secondary and what not. Thus, the whole movement from February to May inclusive was downward but it was broken by shorter swings

within. Should the movement from February to the end of March be called a primary swing? The answer is, that it is all a matter of words. The situation was unusual as shown on a chart, but the whole period named was a period of liquidation precedent to another upward movement by the dominant interests in the market. Precedent to this upward movement starting at the close of May was a period mostly of accumulation during which the seesaws of April appeared. This seesaw period also witnessed certain belated liquidation by losers. The entire February-March break, though marked within itself by an upward reaction, was itself but a big reaction from the overbought market of January and the earlier days of February.

If the reader will now cast his eyes to the earlier part of the diagram, he cannot but be struck by the fact that the rise from 1921 to 1926 resembles the rise from 1897 to the summer of 1901. The long seesaw period in 1922-24 has its previous parallel in the similar period of 1899 to the early Fall of 1900. The huge break in February-March, 1926, is the very image of the smash on the afternoon of May 8, 1901, the swift reaction, the nervous market of the first half hour of May 9, 1901, and the crash in the following hours when Keene broke the market with the full consent of the great interests who desired to shake out the unwieldly public then in the market, already terrified by the concurrent corner in Northern Pacific common.

The likeness between what followed in 1901 and in 1926 has continued to run broadly but not so exactly parallel. This *broad* likeness to the years 1928-29 the reader will see exhibited in three other great mar-

kets. From the summer of 1901 to the Fall of 1902 was a seesaw period but with great general strength and with the upward flare of various single stocks. So 1906 was a great and strong seesaw market precedent to the bear market of 1907. Likewise, 1916 was another great seesaw market after the rises of 1915. There is no later large analogy.

BEAR MARKETS

Now let the reader notice that the following periods were obviously primary bear markets: 1903, 1907, January to midsummer 1910, 1917, the fall of 1919 to the end of 1920 and no period since then till 1929. Before the reader observes the following points, let him remember that when we speak of the movements of the market we mean the movement of the real market on the floor of the Stock Exchange; and that, if in the years previous to the closing of the Exchange on July 31, 1914, he is asked to consider the railway averages, and, in the years later, the industrial averages, this is because, as a matter of concrete fact, the center of the market has shifted from the railway stocks to the industrials, and that the shift, owing to the War, happens to be rather sharply delimited by the closing of the Exchange. When he compares the movement of the railway averages of, say, 1902, with the movement of the industrial averages of 1926, he is making no breach of continuity for our purposes, for the market is based on the buying and selling of participants with just the same motives in both periods. The shift of the center of interest from railway stocks to industrials no more implies a gap in the market than a shift

from interest in St. Paul to interest in Union Pacific did years ago.

This fact being kept clearly in mind, we may note that it is not the first peak of a bull market which is followed by a bear market, but rather the bear market comes on the heels of the last great activities of the expiring bull market. Thus 1903 followed on the strong and active but not generally upward market of 1902; 1907 in similar manner on 1906; 1917 on 1916. In the case of the bear movements of 1913 and 1920, the same situation appears, though the facts are not on such large scale. We may, therefore, say that a great bear market follows at once on the culmination of the last great bull activities in a previous bull market but that the first peaks of the bull market are followed by other peaks or by large seesaws till finally decisively succeeded by the bear movement downwards.

Let us now consider the general course of a great bear market. In all such markets certain similarities of a technical but most important sort to the speculator will appear. Let the reader consider any of the bear movements referred to. The downward secondary movements are steep—that is, they happen within very short periods, sometimes within a few days, or even a day or two. The immediately following upward rally is generally longer in point of time. A bear market, in other words, goes down by successive plunges in contrast to the steady, even when swift, ascent of prices in a general bull market. Or, to put the same thing another way, the successive spurts in prices in a bull market (the upward secondary swings) take up a longer time for the same price difference than do the

converse slumps in a bear market. Even from the observation of carefully drawn charts, the conclusion is plain that a bear market goes down about twice as swiftly as a bull market rises. Moreover, and this is of great practical interest—the falls in a bear market concentrate themselves on a relatively very few days while in a bull market they are spread out over many days. Of course, the bear market may also exhibit a general, constant sag.

ANALYSIS OF BEAR SITUATION

It has been said that a bear market proceeds by a series of constant "fits and starts." Also, that "the rally in the bear market, like its rapid precedent fall, is relatively quicker in the time of its occurrence than is the recession in the bull market after the precedent rise." Examination of the diagrams, however, does not confirm this latter view with sufficient exactitude for it to be regarded as a practically useful observation. Finally, it must be emphatically noticed that such breaks as those of May 8th-9th, 1901 and of February-March, 1926 have no analogue at all in a bear market. For such instant and intense reversals of form could occur in a bear market only if the whole market were cornered.

The divergences remarked above are not inexplicable; they are, on the contrary, capable of rather detailed analysis; and this analysis it may be interesting to conduct. Let us first examine the function of short selling in the market. One of the most obvious points connected with this phase of market activity is that the number of those engaged at any one time in selling

short is small compared with the number of those who at any time whatever are long of the market. The public, as a whole, are never on the short side though a section will be found among the bears at about the close of the decline when, they are, of course, losers. Short selling goes against the popular grain and, moreover, the process seems always unintelligible to most outsiders at all times. Nor are great financiers apt to be chronically short of the market: their interests are too much concerned with the development of the country's industries, their own control of corporate activities or credits so often involves a long position in certain shares to at least an appreciable amount—that their short activities, when intended to depress the market, are indulged in only for very special purposes and, as concerns the market generally, next to never. It must always be remembered that the mass of investors are on the long side by the very fact of being owners of stock. Hence it is plain that in a bull market those long of stock vastly outnumber (with much greater total commitments) those short of stocks. Short sellers are, in fact, limited to the now small class of stock exchange floor traders and to probably at the right time, a majority of the professional, perhaps of the semi-professional class.

OVERBUYING AND SHORT SELLING

Why can this relatively quite meager amount of short stock put out at certain junctures so effectively break the market? Because when short selling is strongly effective, the market in general or the market

in any particular stock which may come under bear pressure—has been overbought. The buyers are all in the market already, and those who would like to buy more have no more funds wherewith to do so. Let us assume that the entire market is overbought. The shorts who are constantly feeling out the market will at once discern that their offers to sell are not readily accepted—that there is no "support" present. Their stock is taken only at concessions in price and these declines in price are at once registered on the tape by the ticker in every broker's and probably most every important banker's office in America. As the price falls, the margin of speculators decreases. Brokers call for more margin, more sales at falling prices take place, stop-loss orders are executed, and the banks begin to protect themselves by demand for more collateral security against their loans and by calling the loans themselves. Not till new and good buying comes into the market does the process definitely cease. Notice that this downward process depends on three factors: first, the overbought condition of the market; next, the short selling and, thirdly, the calling of loans by the banks. It is plain that the short selling by itself does not necessitate the decline; the decline is necessitated by conditions which force those long to sell. The short sellers' importance consists in this, that they are as a man who should give a small push to an ill-balanced rock on the top of a cliff; the rock goes over. In the same way, when short selling smashes a market, the market is about ready to fall from its own weight of the load of long stock. A bear market is brought about by necessity and not by manipulation.

We have spoken of the habit of testing the market, of feeling it out, usual among professional bears. Throughout the course of a bull market, once there is plainly large public participation, these traders are constantly present, searching for points of weakness and constantly in opposition to the course of the upward movement. The short lines which they put out are primary transactions, that is, they are not intended to close any previous trade. But in a bear market, there is no class whatever, as the market goes down, to give primary repeated upward thrusts designed to impede the course of the fall, no class at all correspondent to the bears in a bull market. Moreover, while in a bear market, the short selling may constantly have power to topple over the unstable market as it plunges down the cliff of price quotations, their buying power, their covering of the short lines which they put out, is related to too exiguous an amount of stock to arrest the fall decisively. In other words, while short selling topples the unsteady rock of the market, short covering has not the importance attributed to it at times, has not the power to arrest the decline definitely, because the amount of stock covered is very small in proportion to the total amount of stock involved in the market. The steadying influence attributed to short covering in a bear market appears to be exaggerated, though undoubtedly effective to some extent.

In a falling market, let the reader further notice that the holders of stock who are forced to sell by exhaustion or diminution of margins, cannot reënter the market shortly after, because very rarely are their funds likely to be replenished so soon. It all amounts

to what has been stated above that in a bear market, the vast mass of the participants (and this includes the investing class) are passive except as the demands of brokers and banks force them to sacrifice their holdings. Nor must we omit to remark that, in bear markets, when prices fall lower and lower, the public mind becomes generally upset by this mysterious condition of things. Who are they that keep on selling and what is their purpose? That the situation is one of prolonged and enforced liquidation due to the deflation of bank loans is next to impossible for the public to see. In all of the great bear markets since the beginning of the century, except in reference to certain phases of the last months of the 1907 bear market, the process of enforced liquidation will be found to explain the situation as concerns the general stock market. The phrase used by the late J. P. Morgan in reference to the bear market of 1903, that it represented the sale of "undigested securities" is true in the main of all bear markets, however this fact may be masked by special circumstances.

DOUBLE TOPS AND BOTTOMS

After this glance at the salient characteristics of bear and bull markets, we may note certain market technicalities which are not without importance. When a stock, for the first time, advances to a high figure it reacts, and then often comes back to the previous high figure. When this process happens two or three times in succession, the figures attained are called "double" or "triple tops" and are often regarded as evidence

that the movement for the time being has ceased. These tops are usually easiest observed at the culmination of a smart secondary movement upwards. For example, in the general market, double tops were made in January and March, 1925. But these tops may be better seen in special stocks, where they are apt to occur at very much shorter intervals than in the averages of the whole active market. These tops represent either a distribution of stock or they represent the purchase of additional stock by the same owners who are responsible for the rise. The market is thrust upwards repeatedly to induce new public buying, in the former case; and, in the latter case, meets new selling each time the sponsors of the movement desire to press on the upward movement. But the exact interpretation of these special moves is generally obscure and tentative unless information of the intentions and actions of the holders of the stock is obtainable. The reader will notice that it is sometimes hard to say when such tops should be considered as the culmination of secondary moves and when only of tertiary moves. Dow's theory of the market must not be pressed too hard in these situations. It is quite sufficient if the theory aids the observer in understanding the course of the market; we must not look for a simplicity which does not obtain in real life. Double and treble tops of a converse sort are also to be seen at the bottom of a decline.

Another feature worth close attention is the situation when a stock breaks through a previous high or low point. Before this breaking out of the price into new territory occurs, the market may have fluctuated

between certain upper and lower prices for a considerable interval. If the stock breaks through the low figure and falls farther, it will often be found that marginal speculators have been affected and that the decline indicates their forced liquidation, as their margins weaken. On the other hand, when a stock gets into new high ground, either there has been a strong accession of buying power which has swept offerings before it, or it may mean simply that the offerings have already been absorbed and that bidding in the market meets with so few offers that the price may be rapidly put up. From another angle, these points will be considered further when treating of the manner in which those actually dominant in the market exercise their control (*see* Chapter VIII).

SIGNIFICANCE OF A "NERVOUS MARKET"

It must be evident from all that has preceded in this chapter that the data on which to call a fall are more explicit than those on which to call a rise. On the eve of a great break most any old-time broker can point out the dangerous situation to the very few customers who have sense enough to listen to him and to heed his advice to lighten their long stock while there is time. The prelude to a great break is often shown by what is called a "nervous market." This means that activity is large but that prices though not definitely weak fluctuate with unusual speed up-and-down, while the gaps between prices tend to be larger than the minimum eighth of a point usual between the divergent sales in the same stock at ordinary times.

This sort of market, once seen, is readily remembered, for its characteristics are striking. If, when this sort of market exists, prices are plainly above investment values, the condition is as near a positive indication as can ever be expected that the market is a sale right then and there. The height of prices over investment values is not at all decisive by itself as this condition may obtain for long periods.

The technical superiority of the bear position to that of the bull is thus due to more readily interpretable market situations.

CHAPTER V

THE BANKS AND THE STOCK MARKET

The relation of the banks to the stock market lies at the very basis of stock market activities and the understanding of this relation is essential to any thorough understanding of movements in prices in that market. We have noted that while the purpose of the market from the viewpoint of financial and industrial leaders is often for corporate control and for affording investment facility to the public, yet, in fact, the character of the market is predominantly speculative—to the extent of something more than 95 per cent of all transactions. Further, it has been noted that the motives behind speculative activities are pecuniary ambition and pecuniary caution. But the existence of these facts and the appearance of these motives is conditioned partly on the supply of shares in any given stock and on the distribution of these shares; and, very much more, by the relations of the speculative commitments to the bank loans on which these commitments are necessarily predicated.

Taking the American banking system as a whole, it should be noted that it is not primarily a reservoir of actual money in gold or silver. Rather, it is, to quote the words of a noted English financial writer, a "manufacturer of credit." While the total amount of actual money—gold and silver—varies with the import and

export of these precious metals, yet at any one time the amount of deposits in all the banks may be some seven or eight times or more the total amount of money. On the other hand, the amount of deposits is not so very different from the total amount of loans. When a bank loan is made, the borrower is debited with the amount of the loan and credited with its proceeds in his deposit account and thus loans and deposits grow hand-in-hand. When a loan is paid off, the borrower draws a check against his deposit account in favor of the bank and the loan and deposit cancel simultaneously.

But here the reader may ask: How can a bank loan so much in excess of its money on hand? The answer is simply, that the bank does not really lend money but lends credit. But while this answer is complete, it does not cover various points which must be glanced at to make the matter entirely clear.

NATURE OF A BANK LOAN

Bank loans are based on collateral, or pledges. In the case of commercial and industrial loans these pledges need not always be pledges of either definite goods or of definite rights to goods; they may be simply pledges, by promissory note, of the borrower's general responsibility to the amount of the loan. But for our purpose we do not need to dwell on this business phase of the matter nor on the establishment of the acceptance system to a certain extent within recent years. If we confine ourselves to such loans as are based on definite collateral, we find that this

collateral may consist of warehouse receipts, bills payable (to the borrower), real estate and real estate mortgages, government obligations, and securities generally. To use a figure of speech, the bank turns the fixed value in these sorts of wealth into liquid form, by means of its loan and the concurrent deposit credit and the borrower can now use this value by means of his own checks to obtain other goods. It is in this way that the activity of a bank has been described, as noted above, as a manufacturer of credit.

It is plain that in the ordinary course of business, depositors are drawing checks and depositing remittances continually. Yet it is conceivable that a definite bank might feel, at some particular time, so great a volume of checks against it that its incoming checks would be wholly insufficient to cover the drain and that its monetary resources might also be impaired. If this should happen, the bank under the present Federal Reserve System can rediscount at a Federal Reserve bank any of the collateral it holds which falls in character under certain regulations. But a more general and more interesting example of banking strain would occur if there were that outburst of financial unreason known as a panic, and if the panic were accompanied by a "run" of depositors for their money. While nothing of this kind has happened on a large scale since 1907, yet it is plain that were it to occur on a vast scale, the banks could no more pay out actual money now than then, because they have nothing like the amount of money sufficient to cover their demand deposits.

How, then, has the Federal Reserve System reme-

died the defect of the old system of banking and how does it obviate the dangers of a panic, should a panic eventuate? The answer is, that in a panic what every one wants is cash—what everyone else will take readily in exchange for goods. Now, bank notes satisfy this demand; but in 1907, for reasons on which we need not dwell, there were not sufficient bank notes on hand or procurable under feasible circumstances. We have noted that the deposit entry against a loan is the liquefaction of the value in the goods or rights to goods or personal responsibility which has been pledged. But if the borrower needed actual cash, as to meet a payroll, he might obtain actual money—gold, silver, or gold and silver certificates or other legal tenders—or he might obtain bank notes. A bank note and deposit credit are, in theory, the same, but the instant negotiability of the bank note as compared with the very small possible turnover of the check introduces an immense practical difference. Finally, we might note that bank notes and checks are not money because they are not made of a substance, like gold, otherwise valuable; but they represent the values over which the bank by acquiring pledges, has acquired control. In a word, modern banking is a sort of refined system of deferred or suspended barter, as it has been often termed.

It is now necessary to speak more in detail concerning the present, or Federal Reserve System which supplanted the old banking system, on August 10th, 1914, though the changes in detail worked themselves out in the succeeding years. We must, however, first notice the two general differences between the two

systems and this we may do very shortly. The former difference, that consisting in the manner in which bank notes may now be readily used to meet instant calls on banks during "runs" we have just noticed. The other difference is that gold funds of the banks have been massed in a series of bankers' banks, the twelve Federal Reserve institutions which are guided by a Federal Reserve Board of eight members at Washington. The gold of the banks formerly kept in the banks' own vaults has gradually become collected in the twelve banks mentioned, where it can be used at once in any part of the country or abroad should need for its use (as in foreign complications) arise.

THE LEGAL RESERVES

But the old system of banking was defective not only in the matters mentioned as well as in certain other really important matters unneedful here to recall; it also was maladjusted by certain banking laws which long experience had proven to be fraught with evil at certain times. One law to which we must direct attention compelled the national banks in New York to keep on hand at all times in their own vaults 25 per cent of the amount of their deposits, in actual gold. This reserve, as it was called, was forbidden by law to sink below that figure and when, as in the panic of 1907, there was a drain of gold which carried it below the 25 per cent mark, the banks began to refuse cash payments, partly in perhaps unwise timidity but also from the very real danger that some fatuous politicians might bring them into trouble for using

these very reserves which common sense and English banking practice alike, had dictated should be used, and used freely, in times of panic.

We have seen just now how one part of the difficulty has been remedied by the present instant availability of bank notes. But the figure of 25 per cent reserve was much too high, especially when the easy utterance of bank notes was brought about; and when, as has happened in the years since the War, the American public has become educated to the acceptance in all business of Federal Reserve notes as readily as gold certificates in the East or as actual metallic gold coin in certain parts of the West. These reserves are now legally placed at 13 per cent in New York and Chicago against demand deposits and at 10 per cent in 63 other large cities. In the banks in smaller districts, —the "country banks" as they are called, the legal reserve need be only 7 per cent. These reserves consist of the balance each bank has on the books of the Federal reserve bank, and in practice they are, of course, often considerably in excess of the legal minimum figures just quoted. If the reserve of any bank becomes low, the bank may at once raise it by rediscounts at the reserve bank.

We must now say a word in exposition of the structural nature of the present banking system. This system is conditioned, to a large extent, by the very nature of the American form of government, state and national. All the national banks are legally within the Federal Reserve System and the State banks and trust companies may, under certain conditions, apply for membership and be received into the system. Rela-

tively but few have done so. There are twelve Federal Reserve banks situated in the chief banking centers of the twelve districts into which the country has been partitioned. Bank Number One is in Boston and serves the banks within the System throughout almost all New England. The Second Federal Reserve bank, that of New York, serves the national banks of New York State and of a small section of Jersey and of Connecticut. Each bank has a governmental overseer called an "agent" and all the banks within the twelve districts are under the general control of a committee of eight members at Washington known as the Federal Reserve Board, six of the members appointees of the President and two, the Secretary of the Treasury and the Comptroller of the Currency, ex officio. The Board acts as a general manager of the entire System but its precise relations with the twelve banks are often quite elastic and in various respects not definitely delimited by statutes. Its most important recognized and accepted function, from the viewpoint of this discussion, is its supervision of the rates of discount established primarily by the several reserve banks.

LOANS ON STOCK COLLATERAL

We now approach nearer to the relation of the banks to the stock market. The banking community of Greater New York in a way, now rather definite, now quite vague, tends to act very much by a general consensus of opinion in regard to most financial matters with which it comes into contact. In part this is due to a general interrelation of interests among the great

financial powers and consequent tendency towards uniformity of action. Thus, the banking institutions as a whole act in regard to stock market speculation in a manner similar to their attitude towards other great financial processes, namely, from a decidedly unified standpoint. If this were not so, market conditions would be quite different from those which now obtain.

Now the actual point where the banks touch the market is in their loans on shares of stock. It is customary for banks which lend on the pledge of securities to make the loan to the maximum amount of about 80 per cent on the stock market price current at the time of the loan. The banking theory in this matter is that loans on stock and bond collateral should be of a liquid nature like loans against commercial notes and not fixed for a period, as a loan on real estate would be. In the case of a commercial note or an acceptance, the bank, if a member of the Federal System, can now rediscount the paper with the Federal Reserve Bank of the district, but it can do no more with the stock or bond collateral (unless of United States Government origin) than before the initiation of the Reserve System. In their desire to nullify speculation in the stock markets the authors of the Reserve Act forbore to allow banks to rediscount share or bond collateral. Hence the banks have followed strictly their former practice, namely to lend on stock collateral on the basis of current exchange quotations and, in general, only when the stock is sufficiently active to justify a certainty that it can be at once vended on the exchange where it is listed.

As it is most important that this matter should be entirely clear, let us take an example. An individual investor who owns 100 shares of Steel common desires to borrow on the shares as collateral. We will suppose that, at the time, Steel, in the course of its many peregrinations, is in the neighborhood of $125 a share. Our investor's banker who is, of course, quite familiar with current stock prices is probably willing to lend $10,000 or 80 per cent of the market price. He would be even more willing to lend if the borrower were content with $9,000, for the banker likes a full margin of 20 per cent kept on his loans. The loan may take the form of a time loan of several months with interest fixed in advance; or it may take the form of a call loan renewable from day to day. But call loans are not so frequently made with individuals as with brokers.

The investor has, therefore, let us say, borrowed $10,000 at 5 per cent on the security of his Steel common. His dividends will more than pay the interest charges on the loan and on this score he has nothing to fear. As long as the price of Steel remains steady in the stock market or should it advance, the investor need do nothing. Moreover, under these circumstances, when his loan matures he will probably find the banker quite willing to renew the loan, whether at the old or at a new rate of interest. On the other hand, the stock prices may fall on the Exchange. In that case, the banker will be likely to demand of the investor either that he put up more collateral as security or, failing that, that he pay off the loan on the spot. The latter demand of the banker is known as "calling the loan."

It should be remarked that, whether the loan be on time or on call, the banker has it in his power, if he so desire, to terminate the arrangement and close the loan. Funds are loaned to brokers mostly on call rather than on time, so that the loan, without useless formalities, may from day to day be based on the interest rate current; and so that the broker, on his part, may quickly terminate the loan whenever he wishes to retake the collateral (as when it is ordered sold by a customer).

BASIS OF COLLATERAL LOANS

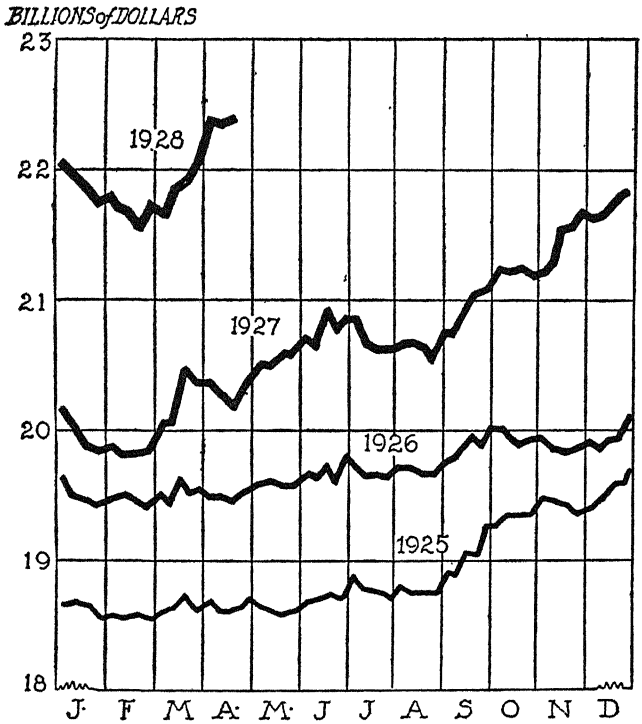
Since the banker cannot rediscount the loan at the Federal Reserve Bank, he must be prepared to compel its repayment by sale of the collateral, if the borrower should be unable, on demand, to take up the loan or ensure its immediate satisfactory rearrangement. In this case, the banker orders the collateral sold on the Exchange or, sometimes, at auction, and after deducting his loan and charges from the proceeds of the sale, places any balance remaining to the credit of the borrower. Thus, under the necessity of reconverting at once loans on stock into liquid form,—the banker is obliged, in self-protection, if for no other reason, to loan on stock on the basis of current price quotations. For, only by watching these quotations can he learn when his collateral is falling in salability and when he had, consequently, better delay no longer to fortify or to call the loan. A corollary of this is, that loans on unlisted stocks or on stocks which, though listed, have a very narrow market, are either hard in varying degrees to obtain or positively impossible to

obtain; moreover, should the loan be obtained, its proceeds placed to the borrower's credit may represent a quite small percentage of the apparent investment value of the stock. Thus on a hundred shares of unlisted stock of a corporation dealing in semi-staples and which has paid 6 per cent for eight or ten years, a bank may not be willing to loan more than $2,500 or $3,000, if, indeed, it be willing to loan at all. On the other hand, some "cat" or "dog" listed on a great exchange, provided its sponsors keep the prices fairly active, will probably find some bank ready to make a loan on a margin of no more than 30 per cent or 40 per cent, relative to the current market price.

One consequence of this situation is peculiar to the American stock markets and is of the highest importance. Since the banker lends on the basis of current exchange prices when these are not grossly out of line with apparent investment values, it is evident that, within a quite wide range of current quotations, he will lend much more, for example, on shares when they sell at par than when they sell at $75. The banker's concern is not about a fair appraisal of the stock by means of accounting, engineering and other reports about its corporation; his concern is whether, if he loan on that stock, can he at once, if needs be, retake his funds. Hence if the market moves upward and continues active the banker is quite willing to advance his loan as the stock advances.

Let us take an instance. A pool has, let us say, some 50,000 shares of a stock quoted around $75 a share. The price, it may fairly be argued, is too low; the stock ought to sell for about par and the pool purposes

to advance the quotations to about this neighborhood at least. The market value of 50,000 shares at $75 a share is $3,750,000 and the pool may quite probably



GROWTH OF TOTAL LOANS AND INVESTMENTS OF ALL REPORTING MEMBER BANKS, 1925 TO 1928

be able to borrow about 80 per cent of this amount or $3,000,000 from several friendly banks, particularly if the stock pays dividends. It really does not matter exactly how much they do borrow for the purpose of this illustration. However, we will assume that the

shares are advanced in price to $85 in a short time. Now, at this quotation the 50,000 shares are worth $4,250,000 or half a million more than previously. If the pool needs 80 per cent of this half million, or $400,000, and the banks, who watch these manipulations carefully, feel that the sponsors of the movement know their business and are reputable customers, they will probably advance this additional $400,000 or some similar sum without hesitancy. Indeed, they are aware that the pool counts on this additional aid.

PYRAMIDING COLLATERAL LOANS

Of course, in practice, the banks decide each case on what appears to be its merits and, save in those very rare cases where the bankers themselves become too sanguine,—the banks guard themselves well. The point to notice is that it is bank funds that made the upward movement possible. The banks by aiding the pool have created the very prices on which they, anew, are now ready to lend more funds. It should also be noted that the additional $400,000 which the pool's advance of prices has induced the banks to lend, may be needed by this pool to buy more stock, as it may not be quite ready to unload at 85 and may have to absorb some offerings at that figure. Thus, by "pyramiding" their loans on stock collateral, the banks bring about the very prices on which they rely to expand the loans.

Let us assume that the pool puts the stock up around par, as intended, and that the 50,000 shares are duly distributed at an average figure not so much below

that price. Some investors have probably taken some of this stock and it is now out of the market entirely, for the time being. But most of it is probably carried by speculators through brokerage loans and these loans are as near to 80 per cent of the market prices as the banks have been induced to loan by the brokers. The stock price is now in a very vulnerable position. For no one in sight wants to buy more. A little liquidation or short selling and the price will take a tumble. At once, the banks judge that the collateral pledged no longer guards adequately the loans. They begin to "discriminate" against the stock, demand of brokers that other stock be substituted in the brokers' loan envelop. The price still falls. The banks begin to call loans and to meet these calls, the brokers demand more margin from the customers long of this stock, and when the customers are unable or unwilling to put up additional margins, the broker declines to help them out with his own funds. The shares are therefore thrown on to the market to bring what they can; the price falls still more, bank loans on the same stock rather better initially margined are now in turn weakened, these loans are called and more stock thrown on the market to be absorbed at still lower prices. The banks by calling their loans now topple over the very pyramid of credit which they helped to build up. And this deflation continues till there are no more such loans to call or until strong buying enters the market, attracted possibly by the low prices compared with the apparent investment value. The end may come soon in this way or the stock may not cease its price decline till really surprising shrinkage has occurred. All this

time, the business of the corporation whose shares are in question may not be altered a whit either for good or for bad. The whole rise and fall in the price may have positively nothing behind it at all but the desire of the original market group to sell high and the alternate extension and withdrawal of bank credits.

Though call loans by banks are not at all infrequent in Europe on the basis of business paper, our own system of call loans on stock collateral is not in use, as settlements are made for the account and not on immediate comparison and delivery (*see* Chapter I). But we must notice that, although the banks cannot rediscount stock collateral with the Federal reserve banks, yet when they wish to extend their loans in the stock market, they can increase their resources by rediscounting with the reserve bank of their district, most any other sort of collateral. Consequently, as, in fact, the banking resources of New York City are now far greater than the present demands of speculators, the control by the banks of the loan situation, as indicated in the imaginary example above, is not nearly so *forced* as it was before the Federal Reserve System went into effect. Before that time, it was actually possible to determine whether or not the banks could allow further speculation simply by two comparisons, one of their reserves with deposits, the other of the deposits with the loans outstanding. The reserves had, by law, to be 25 per cent of the amount of deposits, and, as any loan increased the borrower's deposit account without increasing the reserve, this law at times compelled the banks, willy-nilly, to husband their loaning power.

The connection between loans and deposits also influenced the bankers. If deposits fell heavily while loans did not, it meant that the bank was paying out on balance actual, concrete resources generally in gold and that its reserve was, therefore, shrinking directly or indirectly. The excess of deposits over loans or vice versa was known, respectively, as the surplus deposits or surplus loans. These two definite indices afforded a real basis for predicting market prices, as the banks could extend credit readily when the deposits were in excess and could not readily do so and keep within the law in the converse situation. At the present time, though the banks cannot rediscount securities with the Federal Reserve Banks and must, therefore, to guard against particular losses, loan only on the basis of market prices—yet they can maintain their power of extending credit by rediscounting other liquid resources. This factor and the other factors associated with the Reserve System have so strengthened the banking power of New York that very wild speculations would be possible were the situation not guarded alike by the judgment of the Reserve Bank and of the great New York banks in particular. (See Chapter XII.)

TWO HISTORIC INSTANCES

It would seem appropriate here to give a clear instance of the former state of things. We may, therefore, turn to one of the few first-hand, detailed studies of stock market situations, "Two Stock Market Culminations," a little-known brochure by the late Henry Hall, probably the first financial man to develop the

now well-known idea of accumulating a personal competence by mature life, through speculative investment. We may recall that in the early Fall of 1902, an extended speculation in Southern Pacific was engineered by Talbot J. Taylor & Company and that the late John W. Gates and his associates were then aggressively bulling St. Paul. The banks were ceasing to extend further loans. "The demands," proceeds Mr. Hall, "both of legitimate business and of the speculators had utterly exhausted the loaning power of the American banks. Five brokerage houses in New York had alone borrowed $100,000,000. Mr. Gates hurried to London, in September, hoping to secure further advances of money at that center to go on with the bull campaign. He was unsuccessful. At the New York Clearing House banks, surplus deposits had fallen from $98,000,000 in 1901 to $1,300,000 in September, 1902, going below zero the next month. Surplus reserves had vanished; and there was an actual deficit in the week ending September 20. The natural consequence was tight money. Call loans touched 8,20, 20,25 and 35 per cent in successive weeks, and for time loans 7 per cent was demanded." This was the culmination proceeding the great bear market of the following year.

Elsewhere, the same writer continues: "In the Fall of 1906 the position of the banks was frightfully strained. Call money touched from 12 to 36 per cent in every week in November and December, and while stocks reacted in consequence, in the latter months of 1906, eminent financiers refused to believe that the bull market had ended, or lay aside their plans for railroad deals of various sorts. They made a diligent

effort to induce President Roosevelt to modify his hostility to corporations or to issue some statement, which would reassure investors. They also tried to secure an emergency currency law. Failing in both completely, they finally resolved to let matters take their course. In 1907, a few more prominent corporations increased their dividends and manipulation was continued, all for the purpose of holding the market as strong as possible, but meanwhile there was a quiet but persistent and tremendous unloading of stocks by pools, inside interests and market operators"—prior to the great decline of 1907 which was more or less clearly foreseen by this time.

CALL MONEY RATES

We have not yet discusssed the relation of call money rates to the stock market. In fact, there is no definite relation, though there does prevail among public speculators a vague sort of an idea to some such effect. Before the entry of the United States into the late war, call money was bid and offered on the New York Stock Exchange in the same manner as if it were a stock whose shares were bought and sold at one of the trading posts. In those days, amounts much less than $100,000 (the present unit of loans) were often lent out, and sometimes when an excited broker needed $25,000 or so, he might bid considerably above the prevailing rate. At other times, "wash loans" of call money were undoubtedly made to offer a pretext for selling the market short because of "high money rates." While the course of call money rates from the

beginning of the century to 1917 reflects in a general way the condition of the banks of New York, yet this factitious character of certain loans and the lack of any record of the volumes of funds loaned as compared with the interest rates,—make these data unsuitable for a satisfactory statistical study to determine any definite correlation between call money rates and stock prices. Of course, when rates were very low, it did indicate that the banks were in a position very readily to lend and that, other things being favorable, a speculation for the rise might be engineered as far as bank assistance was concerned. But this did not prove that the speculation would arise.

INTEREST RATES ON LOANS

Since the armistice the Federal Reserve Bank of New York has used all its influence to keep the call money rates more even and its efforts since the bear market of 1919 to 1920 have been rather successful. As the call money rate more or less logically follows the rate of discount on commercial paper, attempts to correlate bank credits with stock prices have tended to consider this latter rate rather than the call rate, as was noticed in the preceding chapter. Now, as in former days, a long continuance of high call rates indicates that large loans have been made, but that is all it does indicate. A smart rise in interest rates *not* following the rate of discount on commercial paper, still means the same as it always did: that the banks are applying their preliminary brake to the market. Plenty of credit may still be on hand but the leading bankers

may deem the market much too high. The last week of May, 1928, representative stocks returned less than 4 per cent on their price—from an investment standpoint, were plainly too high. Due to action by the larger New York banks and Federal reserve authorities, the interest rate grew firmer than at any time since 1921, call money rising as high as 6½ per cent, while time money against exchange collateral was 5½ per cent for all periods. Signs pointed to even higher rates with a sequel of enforced liquidation.

BANKING DATA SINCE 1914

We must reach the conclusion that the data furnished by banking conditions, on which to predict long or short time rises and falls are nothing like so definite as under the old banking system. The up-and-down movements still depend on the flow and ebb of bank credit, but the reservoir of this credit is now so immense that how its tides will flow is not readily conjectured. From the standpoint of the stock market speculator the old maxim attributed to a member of the New York Stock Exchange seems still to hold good: that the only sure criterion he had ever found of the very high probability of an extended rise was when brokers' offices were bare of long stock. When, in plain words, the public were not in the market, at all.

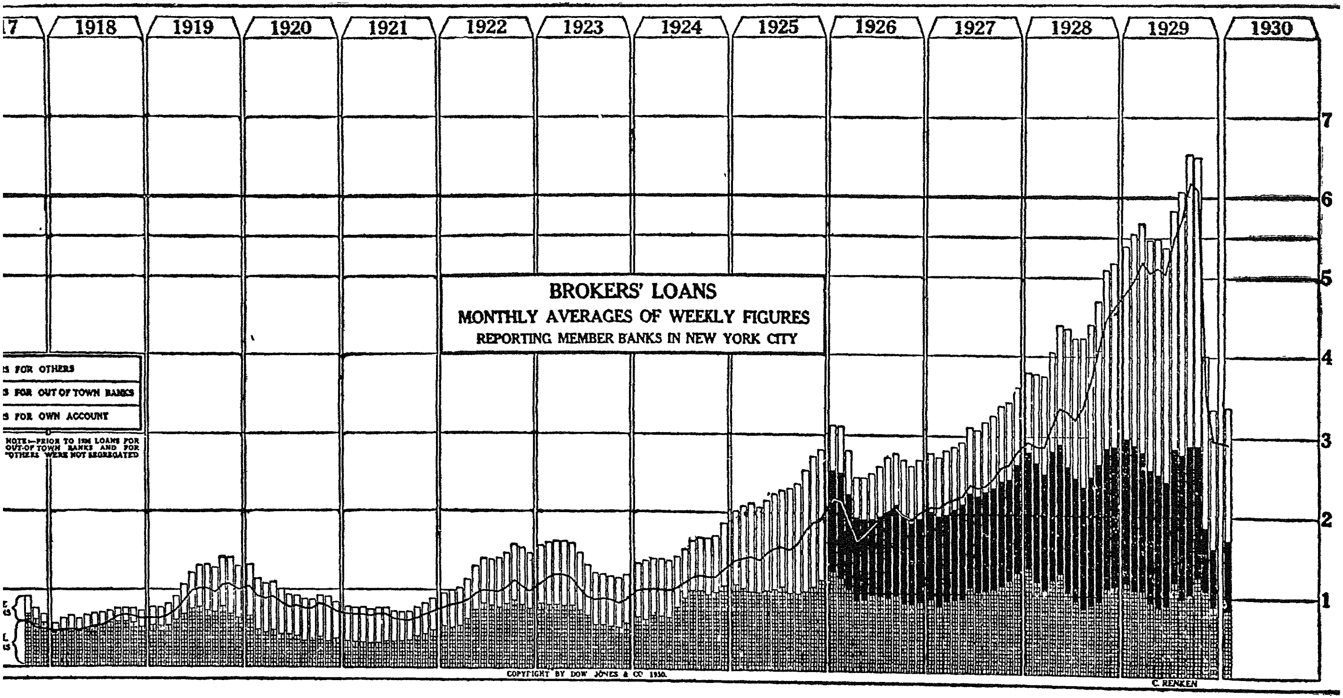
We may close this chapter by adverting briefly to the immense expansion in bank loans on securities since the close of the war. Two reports on this matter are now made, that of the banks issued by the Federal reserve bank and that of the brokers themselves. As

very many individuals borrow directly on collateral owned by them—especially when they are actual investors, it might be supposed that the bank report would show figures in excess of the brokerage report. The contrary is the case. (See chart and compare with Table A, Chapter XII. Brokers' loans were not reported by themselves until the beginning of 1926.) It will be seen that the bank report shows less advances than the brokers' report. Why is this?

A well-known house on the Board writes, "The reason why brokers' loans as reported by brokers are higher than the figures given out by reserve banks is that a considerable proportion of the loans are made with private banks or even with corporations and private individuals. For example, if we borrow money of J. P. Morgan & Co., Kuhn, Loeb & Co., or of the United States Steel Corporation, the loans are not, of course, reported by the reserve banks."

Of the total loans reported by the New York City banks within the Reserve System, a large proportion, sometimes about half, are placed by these banks for out-of-town banking correspondents. A situation like this might have been dangerous to the stock market before the initiation of the Reserve System; now it is of not so much account. While a general recall of funds by out-of-town banks might have potency to inflict a certain shock, such sudden recall is most unlikely as long as the New York banks approve the extension of credit, and the shock could be absorbed, in any event, with little real difficulty by the banking system of New York aided by the New York Federal Reserve Bank.

It is worth noting that when an out-of-town bank


BROKERS' LOANS
MONTHLY AVERAGES OF WEEKLY FIGURES
REPORTING MEMBER BANKS IN NEW YORK CITY
17
1918
1919
1920
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1922
1923
1924
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1930
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S FOR OTHERS
S FOR OUT OF TOWN BANKS
S FOR OWN ACCOUNT
C. RENKEN

lends in New York through the intermediation of its New York banking correspondent, the out-of-town bank can lend merely up to the limit of its surplus reserves—those not in use as cover for its deposits, according to the legal ratio. In other words, the out-of-town bank can lend in New York merely as a non-banking lender of funds, and not specifically as a bank lending credits, rather than actual money. Were this otherwise, the out-of-town bank would have, in effect, a branch office in New York or anywhere else that it chose to lend.

The situation created in 1929 by loans for "others," as they are called, was of temporary significance and needs no special discussion. The effect of these loans at that time is noted in the closing chapter.

CHAPTER VI

CORPORATE CONTROL

The stocks of the great corporations constitute the usual active market leaders on the Exchange. Large activity in the shares of a medium sized or small corporation occurs less often. In many of the great corporations, during the course of years, there may be changes of management, mergers, acquisitions of other companies, readjustment of the personnel of the directory or of the business policies of the corporation. Also, from time to time, a prominent corporation is involved in business troubles so severe that it must invoke the protection of the courts. A receiver in equity is then appointed and his appointment is usually followed by a reorganization and more or less thorough wiping out of the old stockholders.

Situations of all these sorts practically invariably reverberate in the stock market. It will be noticed that these situations are what may be termed "financial" in character rather than commercial or industrial. For the speculator as well as for the investor their importance may be of the highest sort. Before important news of these sorts becomes generally public, those nearest the inside—the directors and the controlling stockholders—are likely to take a definite position in the market in regard to the shares. Before the news of a favorable merger becomes public, for instance, the price is apt to

rise by the buying of those who know of the coming good news and wish to increase their line of shares before the price goes higher. On the other hand, where bad news is expected by the insiders, they will sell part of their holdings; they may even do this and borrow the shares for delivery, in order that the professionals in the Street may believe their disposition of shares is merely short selling by speculative bears.

But, whether the news be good or bad which is to burst on the market, the stock prices begin to get out of line with the general market movement. If the news is bad and the general market trend is distinctly upward, the shares will follow the upward movement very slowly or not at all. If the market be distinctly bearish, and the news very good, the stock will go down much slower than might have been expected.

Each important situation in a corporation's finances has a direct reaction in the market for that corporation's shares. If the situation is very drastic, where, for example, a contest for acquisition of the shares is in progress, the stock price may shoot wildly upwards or it may go up with great steadiness and strength for an appreciable period before developing into a burst of speed. The steady, intensely strong character of the rise in Northern Pacific common in the days preceding the corner in that stock on May 9th, 1901, is a very well-known example. The rise of Bethlehem Steel and of other "war babies" in the spring of 1915 illustrates unusually clear "discounts" by the stock market of swiftly coming prosperity. In more recent years, the Stutz corner is a curious instance of misplaced ingenuity.

There are certain stocks which are more or less active at long intervals and which then relapse into periods of drawn-out inactivity. The reasons in each case are rarely of the same sort. In the Fall of 1916, certain marked corporate dissensions and the possibility of adjusting in some way the back dividends on the preferred stock of the American Hide & Leather Company, furnished an excuse for lively manipulation for the rise in both common and preferred stocks. Several years later, the preferred was run up to over 140 in order to help market a very large block of stock, under Dutch registry before the recent war, which had been bought by certain New York interests at a very modest figure.

BASELESS RIGGING

We have noted the great preponderance of speculative over investment dealings in the stock market, and have commented briefly on the difficulty which manipulators find to carry out any extensive handling of a stock situation without the coöperation or, at the least, the acquiescence of the dominant members of the directory of the corporation whose shares are involved. Of course, there are instances where the directors are merely dummies, sometimes little more than rubber stamps for those really in control. Thus, the little American road controlled by the Canadian Pacific interests, the Duluth, South Shore & Atlantic, has a directory mostly of a dummy sort. The real controlling interests and their New York allies have repeatedly run up and down the shares of the last named road by the sheerest sort of baseless manipulation. Similar sort of

"raw" rigging was in plain sight in the shares of certain of the motor concerns during the last of 1925 and the early boom in 1926. On the other hand, the reader will notice that the manipulation of the General Motors Corporation shares culminating in September, 1926, was a legitimate piece of market control, based in part on the intention to issue a 50 per cent stock dividend against the assets.

In view of the close connection between the conditions within a corporation and the market action of the shares, those interested in the rise and fall of stock prices cannot acquire a rounded knowledge of the subject without clearly understanding how, in real fact, the great corporations (whose shares are not almost wholly absorbed by investors) are controlled by the directing interests. While the facts are known to every well-informed broker and banker in Wall Street, they are not well-known elsewhere and they are not explained in any academic work on corporation finance or the stock market which has come to the present writer's attention. It is, therefore, imperative to dwell on this matter sufficiently to explain clearly the method of corporate dominance.

LEGAL STATUS OF SHAREHOLDERS

Of course, everyone knows that the stockholders elect the directors at the annual meeting and that the directors or their leading spirits direct the corporation. The details of this situation are not, however, exactly what might be fairly expected from a summary statement of the general facts. Let us examine the details with rather close attention.

First of all, it is well to have a clear idea of the position of the stockholders in any corporation. In America, corporations are legal entities with all the business rights and duties of a natural person, save of course those inescapably connected with actual human consciousness. This want is supplied, as far as can be, by the deliberations and activities of the directors. The corporation, and not the stockholders, owns the assets and is responsible for the liabilities. The stockholders, however, own the corporation itself. When a company's assets are sold under court order and the company is "reorganized" as it is called, it is popularly supposed that the concern has gone out of existence. But this is not quite correct; it is true that the concern has ceased to do business, but, unless extinguished by the state for nonpayment of taxes (in the lapse of years) the charter may persist and a "ghost" of this sort endure until a special meeting of stockholders approves its dissolution. Occasionally, a going concern is liquidated by the directors with the approval of stockholders, when the class of business it conducts seems no longer profitable. This happens very rarely with large concerns. The dissolution of the United States Express Company is a good example, while a more recent instance is that of Claflin's, Inc., which announced on October 1st, 1926, the intention of its directory to proceed to distribute the assets and dissolve the company. Under various names this wholesale dry goods concern had been in business since 1843.

But not only do stockholders own the assets only indirectly. They have no right except in rare instances, to more knowledge of the business conduct than the

by-laws allow or than, in very rare cases, the courts will order revealed. Were it otherwise, endless opportunities would be afforded clever adventurers to annoy and harass officials by the simple purchase of a share of stock and a subsequent demand for any sort of information. The idea often expressed among commercial business men that the object of a corporation is to make money for stockholders is not correct from a legal standpoint. The corporation being a legal person, the object of the conduct of the business is to make money for the corporation itself. Indeed, this is the usual attitude of executives towards the management of their business, unless they happen to be the chief stockholders, when personal considerations sometimes enter into play.

CLASSIFICATION OF SHAREHOLDERS

Certain stockholders are always in control of the policy of the company. Primarily this is true of the bankers of the company who usually have one or more seats on the directory (by bankers is here meant the fiscal agents of the corporation who may or may not coincide with its depositaries). If a corporation has an executive committee it will usually be found that its members are apt to be the actual persons in control. On this committee the banker will appear in person or by a representative and the other members will be from the leading spirits of the directory. This little group of three or more men has the most extensive and complete knowledge of the internal situation and no extended market movement in the stock price is at all likely to be possible without their knowledge and at least their

tacit consent. Very frequently, some of them have an active participation in the movement. This participation is practically always assumed to be a fact in Wall Street when a stock moves under large trading in its shares. Of course, all these men are stockholders in the company. This is required by law in order to enable them to sit on the directory. But sometimes their holdings may be small.

In general, we may classify stockholders in a company as follows: first, the directors; secondly, the investors who are holding the stock for its dividend returns or for its expected dividend returns; thirdly, the definitely controlling interests in the company who usually more or less coincide with the personnel of the leading directors and who, at any rate, control the directory and the executive committee, either personally or otherwise. The amount of stock registered in the names of the controlling interests is almost always much less than would suffice to give control if a vote were taken. How the control is actually held will appear below.

We now come to the speculatively held stock, largely making up the floating supply of stock. This floating supply will be treated from the stock market standpoint in the next chapter. Here we have merely to notice that this stock stands mostly in the names of members of the New York Stock Exchange. Now, to be a "good delivery" this stock must stand either in the name of an owner with endorsement of a New York Stock Exchange house or in the name (as is usually the case) of an Exchange house itself. In the latter case, when the stock is sold, the certificate will bear the sig-

nature in blank of the vending brokerage house. But this certificate need not be further registered for transfer, and unless the stock pays dividends, it is not usual to make constant transfers on the books of the corporation. The result is that not only the mass of speculative stock carried by speculators on margin is registered in the name or over the endorsement of an Exchange house but that the name of the brokerage firm on the back need not at all coincide with the name of the brokerage house which holds the stock for a customer. The certificate continues to be as much a good delivery on the Stock Exchange if the signature on its back be a year or more old, as if it were transferred yesterday.

Hence while speculative stock floats about the Street passing from one broker to another as customers give orders to buy and sell, the certificates themselves, if the stock be non-dividend paying, still stand, both on the face of the paper and on the company's books, in the names of the brokers without regard to the actual ownership. A brokerage house at the annual meeting may be able to vote several thousand shares of stock though not a customer in the house owns a share; and, on the contrary, a house where several thousand shares are held may conceivably not have a share registered in its name. (This particular practice was forbidden by the Exchange authorities in 1927.)

But, whether registered in one broker's name or another, these speculative certificates form the vast mass of the speculative stock in Wall Street. Inspection of stock lists will show this fact beyond a doubt. It is, in fact, a commonplace of the Street as far as brokers are concerned. Now, at the annual meeting or

at a special meeting of the corporation, the control of the corporation will ordinarily be determined by the manner in which this mass of speculative stock is voted by the proxies from the brokers in whose names the stock stands.

CORPORATE CONTROL THROUGH SPECULATIVE PROXIES

Before an annual meeting the management of a company (which here means the controlling directors with the bankers and the executives appointed by them)—this management sends out a call for proxies to every registered holder. Ordinarily, those owners who notice the call sign the proxy willingly and return it to the management which will vote it at the meeting. If a contest arises in a corporation, this body of stockholders may vote either for or against the management according to the weight in their eyes of various considerations which differ in each corporate disssension. But, as a rule, brokerage houses will tend to vote with the management as long as that management is supported by the bankers of the company. If these bankers are well-known executives of a great national bank or of a large trust company or if they are private bankers of large renown, they have great influence at their disposal and this influence will quite naturally be exerted to obtain from brokerage houses all the proxies which can in this way be procured. Naturally, an opposition will also try and obtain as many of these brokerage proxies as it can. Some brokers remit the matter for decision to the actual speculators who hold the stock on margin.

It may seem that this control of a great corporation which has a large mass of speculative stock outstanding, through brokerage proxies, is a strange state of things. But constant transfer of certificates from one marginal speculator's name to another's name would be next to impossible even in the case of certificates which are not cleared. With a clearing house, certificates may pass from any one broker to another according to the orders of the clearing house authorities, for a broker receives in actual certificates only the balance of his daily dealings in a given stock; and he may receive this balance of certificates from any other broker at the discretion of the clearing house, and not at all necessarily from the broker with whom he made the actual trading contract on the floor of the Exchange. Similarly, a broker who sells stock may deliver the certificates in the balance of the stock sold to any broker who has bought shares of the corporation and to whom the clearing house orders the selling broker to make delivery.[1]

Since the prohibitory order in 1927, mentioned above, various corporations have found difficulty in obtaining a quorum at their annual meeting. On the rulings of the Stock Exchange, the yearly reports of that institution should be consulted. Consistent control of the directorate in great American corporations by the bona fide investment stockholders cannot be confidently looked forward to until the voting of shares, whether in person or by proxy, is restricted to holders who possess legal

[1] The reader who wants to understand thoroughly the operation of the New York Stock Exchange Clearing House should read and study the detailed explanation by the economist of the Exchange, J. E. Meeker, in his book, *The Work of the Stock Exchange*, pp. 203-296.

and equitable title alike, and whose names appear registered for a reasonable length of time before the closing of the books prior to a stockholders' meeting.

THE "STATIC" STOCKHOLDERS

But we have not yet fully exhausted the classification of stockholders. There is a certain group which is next to impossible to classify from a strictly economic standpoint, because the reasons, in part or in whole, of their constituent members for owning the shares, are not economic reasons at all. Suppose a company has two classes of stock, preferred and common, and the common either pays no dividend or pays an uncertain and faltering dividend. It will be found that there are very many common stockholders who can hardly be called investors because they receive no return or a very uncertain return, and who cannot be fairly called speculators because usually they pay little or no attention to the prices of the stock and retain their holdings whether the quotations rise or fall, year in and year out. Similarly, among the preferred holders may be found men of this stamp—men who are plainly not investors only, for, when the dividend is cut or passed, they still hold the stock through thick and thin. Of course, it is not meant to give the idea that such holders never sell. That would be erroneous. For, if the price of the stock is advanced very quickly to a much higher price, many will sell if they happen to learn of the fact; but, on the other hand, if the price of the stock goes up just as far but goes rather slowly, more of these holders will "hang on."

During readjustments and reorganizations, any one intimately connected with the proceedings is likely to come into contact with holders of this sort. They give various reasons for their pertinacity in staying with the company despite its dubious outlook. Thus, they may say that they like the industry in which the company is engaged, or that they have been over the plants of the corporation and have been much interested in the processes or more simply that they are "used" to the stock and don't want to make any replacement. These men are, of course, possessed of some means or their attitude would be impossible. They may be regarded as the static holders in a company, pretty certain to take a real, even if occasionally rather unintelligent, interest in its affairs. They seem to take a real pride in the company's success and a real sorrow in its difficulties. When discord breaks out in a company, expressions of interest in the situation come mainly from this sort of holder and from large holders who are vitally interested economically. The existence of these static holders is easily demonstrated and their identity revealed by a comparison of stock lists over a period of a year or two when a company meets financial difficulties and liquidation by scared holders begins to take place on a large scale.

Let us now turn to the election of directors at the annual meeting of a corporation. The great majority of American corporations elect their directors by what is called majority voting. A majority of the stock present, if the total number of shares on hand constitute a quorum, elects the entire directory. This method, though customary, is not, however, quite invariable, and several very prominent corporations, such as the

Pennsylvania Railroad, use another method of voting, known as cumulative voting. This form of voting is almost always demanded by a minority group during a corporate dissension, as the method gives proportional representation to all interests concerned. It is sometimes heard that the facts that the Pennsylvania Railroad has never been in a receivership, never passed a dividend in any year since it began to pay dividends and never undergone a reorganization have been due to the practice of cumulative voting. Whether this be so, need not be here considered, but this method of voting, though often described, may be shortly sketched out in a few words.

CUMULATIVE VOTING

The easiest way to explain cumulative voting clearly and exactly seems to be about as follows: under the usual plan of voting, each share of stock may be voted for each and every vacancy to be filled on the Board of Directors. If there are ten vacancies to be filled at the annual meeting, each share of stock may be voted for ten different individual nominees, one for each of the ten vacancies. But under cumulative voting, the ten votes of each share of stock may be cumulated on one individual nominee to fill just one vacancy. Suppose, with ten directors to be chosen, exactly one-tenth of the stock present is voted for one nominee. Then a little attention will show that no matter how all the other votes are cast, nothing can prevent that single nominee from getting a seat on the board of directors. For, if the other nine-tenths of the stock present vote

for ten men, then each of these ten men will have a lesser number of votes than the single nominee. If the nine-tenths vote for nine men, then all of the ten nominees will have the same number of votes each, and all ten will be elected. Finally, if the nine-tenths slightly cumulate their votes and vote, say, for eight men, then all of these eight men will have a higher number of votes, individually, than the original single nominee of the minority; but two vacancies will be left unfilled and one of these vacancies must be filled by the choice of the one-tenth group, as their nominee's vote is the next highest vote.

If the stock held by a minority is considerably greater than one-tenth, but not, let us say, quite a majority, the greatest care in calculation must be taken by the majority. For, sometimes, under such circumstances, the actual minority, by adroitly casting their ballots for a bare majority of the directors, while the majority is hoping to get much more than one half of the board—this minority may succeed in carrying more than half of the board. But if each side casts its vote in due accordance with its strength on a show-down, each will receive representation on the board in exact accordance with the voting strength so shown.

Practical differences between the results of cumulative voting and the results of majority voting are not always so striking. A management will often concede representation on the board to a group, if this group owns a sufficient number of shares to present an equitable demand for one or more places. Particularly, is this so, if the group wishing to enter the board finds favor with the banking interests of the company. Again,

when an opposition develops among the stockholders, the management may sometimes break up the strength of this opposition by throwing a seat, as a sop, to some over-greedy faction among the minority interests.

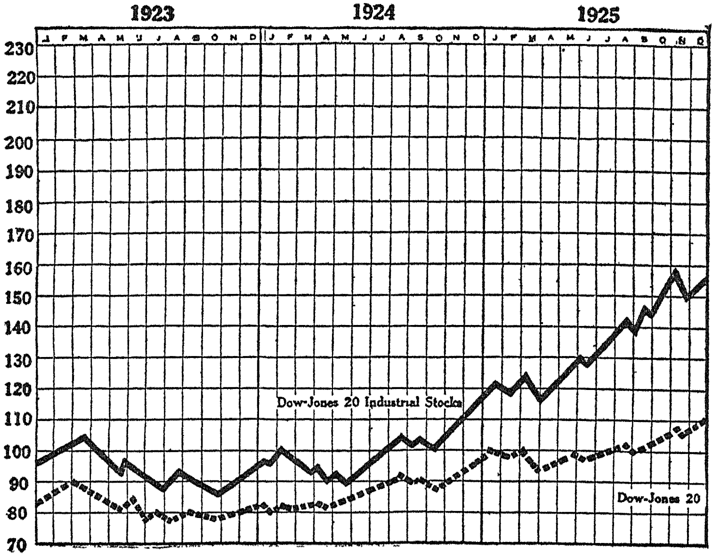
Enough has been said to indicate clearly the interaction between the corporate situation and the stock market. When something unusual is happening within a corporation, those interested in its shares should either obtain a clear view of the situation, or, if they cannot do that, should avoid any speculative entanglements where they have no definite facts on which to base market action and where the stock is plainly getting in some way out of line with the market course or the market's general behavior.

One further example will be given of the close tie-up between the corporate and the market situation. In the early Spring of 1915, the Rock Island went into receivership. Up to the time of announcement, however, the stock had been held strong to enable unloading on the public. The day preceding the announcement, while the stock movements were nervous, they were not pronouncedly weak. On the other hand, the tape began to print sale after sale of large blocks of the junior bonds, at concessions very striking in the bond market. No hint for stockholders to sell out could apparently have been given more clearly. Few outside stockholders, however, seem to have taken it. The following day the stock broke badly, and, shortly after, the price gradually sank down next to extinction and the shares were stricken off the list of the New York Stock Exchange.

CHAPTER VII

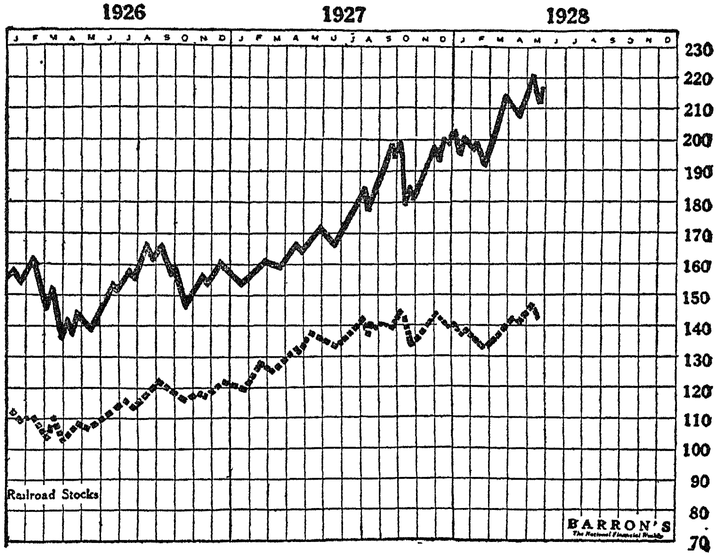
THE FLOATING SUPPLY

The floating supply of a stock is often referred to in Wall Street as a synonym for the shares which can be readily bought from speculative holders. Even in regard to one stock the phrase is not exact. A raise in the bid may one day bring out a certain number of shares while, a few days later, the stock selling still about the same point, the same raise may bring out no shares at all or it may bring out many. Thus, we cannot well speak of the floating supply unless the time also be mentioned. Sometimes, the expression is taken to mean broadly all shares which are not held by investors or for purposes of control. For our present purposes we may best regard the floating supply as the amount of shares in a given stock which are readily brought to market at or not far above the current market price. Here the meaning becomes broad but it is precise and it serves to denote those shares which a heavy buyer, such as a speculative coterie or pool, will certainly first meet with. Probably, most of such stock is carried for speculators on margin with brokers. The fact that shares have a bank lien against them does not necessarily constitute them part of the floating supply; for the owner may renew this loan over and over and may have no intention at all of holding the shares for any other than strictly investment purposes.



RISE IN RAILS COMPARED WITH

It is plain that the more shares of a stock are held firmly by investors, the less of that stock will readily come to market by raising the bid over the current quotation. The result of this situation in connection with the stock price is that very high quotations may be made for a stock and maintained on small transactions,—if the investment and control holders generally are content with the stock and do not try to take advantage of the very high prices to liquidate with profit. (If they did do so, they would soon break the market.) During the first decade of this century, when the New York stock market was definitely under the control of railroad capitalists and their financial associates, some extraordinary prices were made for certain



RISE IN INDUSTRIALS, 1923 TO 1928

great railway stocks. In April, 1902, 8 per cent New Haven was put up to 255; in February, 1906, Great Northern, preferred, was lifted to 348 and the same year Northern Pacific touched 232½. Both were 7 per cent stocks and there was nothing in the prospects of either to justify such prices. (The selling in both instances was to dispose of the Union Pacific holdings of these two securities.) Another rocket the same year was 7 per cent Chicago & Northwestern which sold at 270. In the same year General Electric, an 8 per cent stock, went to 334. During the recent bull market up to the close of 1926 only one railway stock, Atlantic Coast Line, exhibited anything like these old-time balloon characteristics. This stock on the basis of rumors

of a lucrative consolidation was put up to 262½ from which figure it fell to below 195 in October of the same year. Up to late in the fall of 1926 the movement of the railway stocks had been relatively slight. A comparison of the course of quotations on the diagram annexed will plainly show this. It is also plain that, starting with about November, 1926, the railway stocks of the chief systems of America (those shown in the Dow-Jones averages of 20 shares) took on activity and strength which brought their upward course into a parallel line with the course of the industrials. It will be interesting to discuss the causes of this upward movement which proceeded in full strength into December, 1927, when, again, the course of the roads and that of the representative industrials began to run at an angle.

THE "RAILS" IN 1926

It will be well, first, to note that a rise was long "overdue." A writer in *Barron's*, (Nov. 8, 1926) showed that the average price of ten continuous dividend-paying rails had been 184 in 1902, 192 in 1906 and only 127 on October 20th, 1926. On the other hand, the net income was, for 1902, 11.85 per cent; for 1906, just below 13 per cent; and for 1926, 13 per cent. Up to the time of the Fall rise in these rails, the wildest conjectures were rife as to their inactivity, one particularly senseless idea being that the failure to rise was due to decline of purchasing power of the net income compared with pre-war days! Had this explanation been correct it would have been puzzling to explain

the rise in the industrials. This argument also implied that investors were demanding a much higher rate of interest than before the war—a clearly erroneous assumption as the bond market showed no such demand. As soon as the rise began and got well under way, these explanations vanished into thin air.

It is plain that the reason rails did not advance "as they should" up to near the close of 1926 was because they were not bought in amount and manner calculated to put up the prices. In other words, there was no market control present intended to advance these shares. Why was this? A good common sense answer was, that the great owners of the roads had become ultra-conservative since the war and were opposed to rises of a striking kind, owing to their liability to confuse many investment holders. The error in this explanation lay in that no evidence was adduced for such a change of mind on the part of great, directing interests; and that, from a business standpoint, such solicitude for investment owners did not seem justified, if, indeed, it would even have been wise.

The real reason for the delay is not hard to state. After the War, as is well known, the leaders of Congress swung from the pre-war attitude hostile to railway consolidations to just the other extreme. In 1920 the Transportation Act to bring about compulsory consolidations in the following years, was enacted. As is well known, one of the intentions of this act was that the strong roads should absorb and take care of the weak. In April, 1922, the Interstate Commerce Commission opened hearings on the matter which extended over about two years. In 1924 the United States Cham-

ber of Commerce urged the Commission to present a final plan of consolidation though intimating that it believed the consolidations should be voluntary. As is well known, the conditions regarding these proposed consolidations led Mid-West interests to buy up an immense number of shares of some of the Eastern roads. The question has been, should there be four or five roads in the East? Meanwhile the railway situation in general has slowly crystallized into a state different from the pre-war condition in various ways. Among these new ways may be mentioned the new alignment of the roads of the Old Gould system, the reorganization of the St. Paul, the rehabilitation of the New Haven, etc.

FIXATION OF RAIL SUPPLY

Up to 1926 the railway situation was not sufficiently clarified for great interests to go ahead with a speculative movement covering the whole field. And owing to the community of interests in the transportation field among great banking houses, no general movement could start till a general agreement was understood. Back of the interminable negotiations in the railway field, in which the names of the van Sweringen brothers on one hand and of an Eastern railway president on the other, have been most bruited in the newspapers, has stood the fact that the greatest private banking house (not only in New York and Philadelphia, but in the world) and the greatest New York trust company have been deeply involved in the whole series of situations. By them and their associates, outright or as trustees, vast blocks of railway stocks have

been held. Straight through 1924 to the end of 1926 and beyond, this situation has continued. From a stock market standpoint, the floating supply has been relatively small and the condition in the market consequently propitious for a rise. Hence when the rise took place it was easy to engineer. But, as long as the present owners possess their shares, it may be stated as certain that a fall in prices will not happen willingly. After the mergers in contemplation have gone into effect, these shares or a great portion of them may be expected to be sold to the public. In other words, the greatest New York banking interests do not anticipate a change in the stock market of a nature so radical that it will make impossible the vending, in the end, of this vast mass of shares to the public, which they hold for purposes of control and to facilitate their own dominance of the mergers in the railroad field which are in contemplation (May, 1928).

The names of great stockholders and the amount of their holdings are published yearly, as of the preceding December 31st, by the leading railways. These figures appear in the early summer of the following year. By comparing these statistics with the similar statistics for the three preceding years it will be easy in the course of 1928 to determine to what extent liquidation occurred by large interests during the rise in 1927. It will be found that the control is still retained and has not passed to the public, though there has been shifting to some extent of registry without actual ultimate change of ownership. Interesting as would be an analysis of the situation in detail, it is of too special a character to carry out here.

STOCK WITH SMALL FLOATING SUPPLY

Before examining the relation between the fixed and the floating supply of a stock, we must say a few words on the general market position of any listed stock which is well thought of and whose fixed supply is very large. The price of such a stock is plainly easy to mark up. A little buying and the floating supply disappears and a handful of bids will put the quotation up decisively. But, then, to whose advantage is this process? As the sponsors have not much stock to sell, they must turn the same certificates over and over to make a market when they want to sell out. Room traders and brokers' customers alike become shy or are warned against such a closely held stock, and there is great danger that the whole boom may go to pieces at the top while some investment stock, attracted by the high prices on the Board, is quite likely to come to market and to add to the coterie's difficulties.

Even if such a stock from an investment standpoint would seem to deserve still higher prices, it cannot be readily vended to public speculators. Brokers want very large margins on very high-priced stocks and bankers scrutinize the brokers' loans on such collateral with extreme conservatism. Hence, whenever a stock has risen to a very high price which investment values justify, there is nearly always a regretful speculative group near to the company's financial advisers who advocate the "splitting" of each share into several. This process may be carried out by a stock dividend or by an exchange of the shares for new shares on a ratio fixed by the Board of Directors.

LARGE FIXATION DETERS OUTSIDE MANIPULATION

The famous Standard Oil pioneers, the elder Rockefeller, H. H. Rogers and associates, purposely kept the nominal capitalization far within true values to prevent speculative activity in the shares. On the other hand, the desire to keep the stock within the speculative market was probably the decisive factor which caused not a few companies within recent years to increase the number of shares outstanding. Thus, in 1916, the Texas Company reduced its par from $100 a share to $25 a share and thereby quadrupled the number of shares. In the instances of American Locomotive and Studebaker, the shares were made no-par and the Locomotive Company issued two new shares for one old share while Studebaker issued two and a half new shares for each old share. In 1925, American Car & Foundry and American Tobacco each issued two new shares for one old share. Since the peak of the motor car rise in October, 1925, the old Chrysler stock was exchanged for new stock in a ratio of one to four, while the old Nash stock was split into no less than ten new shares. Similar comments might be made on the increase in capitalization of American Can, General Electric and Sears-Roebuck, etc. It is not meant that speculative considerations have been the only ones concerned in these lucrative split-ups, but men of high intelligence and activity must reasonably be presumed to foresee the natural consequences of their actions, and the desire to retain the shares in the market for speculative purposes may fairly be considered to constitute the dominant motive, since,

without these splits, these shares, for the general reasons we have discussed, could not have maintained an active position among the market leaders. It may be added that the motive mentioned is entirely ethical.

FLOATING SUPPLY AND THE "TIE-UP"

We may thus conclude that a prerequisite to an ordinary successful bulling of shares is that the fixed supply must not be too large or it will be difficult to vend the stock to the public when the pool wishes to sell; too much investment stock may be tempted into the market at sight of the large prices and the pool may find that they have to "hold the bag." It is probably from this reason that there has been no strong bulling of Pennsylvania since June-September, 1902. The Berwind group which controlled the movement put the price up slowly and steadily to let investors "get used to it" as well as strengthen their own line. The last ten points of the rise (from 161 to 170) were done on transactions of 29,500, 107,100 and 84,800 shares (September 2 to 4) and on the 5th the transactions fell to 7100. The final distribution was about a week later. This is one of the most curiously careful manipulations ever witnessed on the floor of the Exchange in a stock of prime importance.

A corollary to the statement in the preceding paragraph is, that during the period of a rise, the floating supply must be bought up or tied up until the pool begins to achieve the task of closing out the shares on which it intends to take profits. It should be noted here that sometimes a pool which is not in touch

with the controlling interests may meet trouble from a cause analogous to, but not exactly the same as, that mentioned. Those in control of the corporation may desire to take advantage of the high prices which they see for their shares and if they are convinced that the prices in question are intrinsically inflated, they may take this advantage without parting with control by the simple expedient of going short in the market. No matter how the stock is held, they take no possible chance of a corner; for they can always, if the worst comes to the worst, deliver their own shares against the short sales.

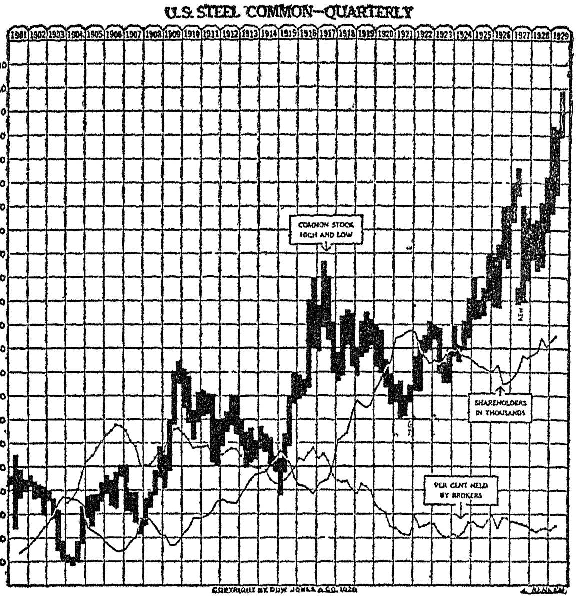
In connection with this matter we may notice the rigging of the Devoe & Reynolds "A" shares in February, 1926. The pool in this stock was made up of operators who had been quite successful in the previous two years, but their handling of the Devoe & Reynolds shares was done without the sponsors being close to the management. It is possible that the operating group had misjudged the situation of the stock. In any event, the stock seems to have been accumulated in January between 90 and 101. In the first week of February it was pushed up to 103. Probably this was to be the beginning of the intended rise, but the news came out that the company's earning power amounted to but a trifle more than $3.50 a share on the "A" and "B" shares combined. It seems certain either that stock from insiders (arguing on the lines just noted) came to market; or refusal of banks to cooperate further upset the traders' calculations. For the stock went no higher than 104⅛ on February 10 and dropped to 40 before the end of the month. It

will be noted that here the obvious floating supply was apparently well cleaned up, but the supply of stock held for control of the corporation hung over the market and from a menace seems to have changed to a disastrous influence. The group here under discussion not only lost heavily but their brokerage houses were supposed to have dropped sums running into six figures.

The reader will note in this example that the final analysis of the situation would depend on a knowledge of the exact relations between the group's bankers and the operators, and that this knowledge can never be acquired except in a general way, merely from the statistics. An attempt for purposes of clarity, to simplify the description of a market movement may be carried too far. There is often an inherent complexity in these matters which prevents their easy classification under general heads. Thus the rise in the rails already adverted to must be regarded partly as laying the basis for great consolidations and partly with the more ordinary intentions of ultimately vending much of the stock acquired at higher prices; but since the dominant interests in these rises cannot themselves positively foresee the exact outcome of the present negotiations for realignment of the railroads under a few controlling centers—they cannot positively determine where they shall finally take their major profits. Hence there has been a certain delay and hesitation in initiating strong rises. But no matter what is the outcome of the railroad consolidations, the rise in prices which has been established will be useful when the final vending arrives.

VARIATIONS IN REGISTRY

The mass of investors, as we have had occasion to note, buys with caution. It is much more apt to absorb stock—good stock—at the top of a rise than to buy at the bottom of a decline. The investment registry of a stock grows at the top of a rise. This fact is sometimes masked by the presence at the bottom of a decline of buying by "bargain hunters" usually in small lots. These buyers are usually presumed to be investors. As a matter of fact they are merely shrewd though timorous speculators—for they usually buy outright, and hold outright or else carry the stock through direct bank loans. The chart of the movements, the total number of stockholders and the brokers' registry (the floating supply) in United States Steel Common is here reprinted by permission of *Barron's*. At the top of the peak of the bull market of 1906 the reader will see that brokerage holdings were predominant—the public owned the stock. It was not then to be classed in the investment group by any stretch of charity and probably few real investors touched it. But at the base of the fall in 1907, the speculative registered holders (the bargain hunters) increased by about 8,000 or 10,000 while the amount held by brokers dropped about 18 per cent of the entire capitalization. On the rise through 1908 into 1909, these bargain hunters seem to have liquidated with skill while the public speculators, as usual, were most numerous when the stock had ceased to rise. From this year onward till the opening of 1915, these two graphs moved inversely, the floating supply falling while the registry of individuals slowly increased. The stock price fell



RANGE OF U. S. STEEL COMMON, 1901 TO 1929

nearly 100 to below 40, and we may, therefore, assume that we are still concerned with the public speculators and the speculative registrants, nearly all, be it observed, of rather small financial caliber and nearly all owning their shares outright or carrying them by direct bank loans.

The stock had an immense rise in the two years 1915 to 1917, going up to nearly $140 a share. There is liquidation of the speculative registrants—the total number of stockholders falling below 40,000, and there is a 10 per cent increase in the floating supply. The fact that the number of shareholders did not fall more

Proportion of Fixed to Floating Supply of U. S. Steel Common, 1904-1928

Year	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	Brok.	Fix.	Brok.	Fix.	Brok.	Fix.	Brok.	Fix.
1928....	23 86	76.14	22.79	77.21	23.95	76.05	24.15	75.85
1927....	27.59	72.41	26.53	73 47	25.69	74.31	25 11	74.89
1926 ..	29.92	70 08	24.1	75.9	29.01	70.99	28.99	71 01
1925....	26 8	73.2	25.45	74 55	24.1	75.9	27.6	72.4
1924. .	22.4	77.6	20.45	79.55	22 82	77.18	26.2	73.8
1923....	26.2	73.8	23.3	76.7	29.8	79.2	20.6	79.4
1922 ...	30.0	77 0	24.1	75.9	25.1	74 9	26.3	73.7
1921....	24.2	75.8	22.7	77.3	21.4	78 6	21.4	78.6
1920....	33.4	66.6	32	58	30.7	69.3	25.2	74.8
1919 ...	38.9	61.1	42.6	57.4	41.6	48.4	39.7	60.3
1918....	44.5	55.4	43.7	56.2	40 8	57.1	40.7	59.3
1917 ...	53.1	46.8	55.1	44 8	52.6	47 3	46 5	50.4
1916....	53.8	46.1	52.7	47.2	56 5	47.3	58	41.9
1915 ...	42.3	57.6	44.4	55.5	46.9	51	49 8	50.2
1914....	49.8	50.1	48.9	51.1	55	64.9	43.1	56.8
1913...	54.7	45.2	51	48.9	50.8	49.2	49.3	50 6
1912....	54.5	45.4	56 2	43.7	57.5	42.4	57.3	42.6
1911....	58.3	41.6	58.2	41.7	55.4	44.5	55.2	46.7
1910 ...	63.9	36	61.5	38.4	57.8	42.1	58.3	41.0
1909 ...	56.1	43 8	63.8	86.4	86.3	34.8	60.4	33.5
1908 . .	50.1	49.8	50.5	49.4	53.5	46.5	57.8	42.1
1907....	65.3	34.6	61.2	38 7	58 8	41.1	50.4	49 5
1906 ...	63.7	36.3	64.8	35.1	68	31.9	60.7	32.3
1905 ...	52.5	47.4	54.7	45.2	57.8	42 2	67.6	39.2
1904....	34.9	65	36.5	63.4	40.2	59.7	47.2	52.7

smartly indicates that here the investment buyer was present. On the other hand, the fact that the floating supply was so little altered shows the highly artificial and unsuccessful character of the successive manipulations. The stock collapsed to below 90 in 1918, rallied, fell, rallied again and then sank to almost 70 in 1921. From the very end of 1916 through these vicissitudes in the price, the number of holders rose, going to almost 110,000 in 1921. Evidently the real investors and the speculative registrants were now commingled.

During the rise in 1922, the latter evidently liquidated again and they do not seem to have touched the stock in any number since. More belated liquidation of this sort followed straight up to the close of 1926, though from 1920 to the end of 1927, the percentage of the floating supply varied little. After the new stock issue, in 1927, the rise shown of new shareholders can only mean that the usual investment buying at such junctures is to be discerned. Then followed the great speculative rise of 1928-1929.

The chart shows the prices by dollars per share, the registry by thousands and the floating supply by percentage. As some readers will be curious to see the last two quantities in the same units, the accompanying table gives the floating and the fixed supply by percentages of the total capitalization.

CHAPTER VIII

MARKET CONTROL

It has been noted that speculative dealings in important stocks, such as those making up the Dow-Jones industrial average, comprise on a quite conservative estimate, 95 per cent of all the dealings in such stocks in the market. Speculative buying makes and maintains the trend of the market, as we have already noticed. The motives which bring about this buying and the identity of the buyers with great industrial and financial interests we have already noted. But a question of the first importance remains to be considered: How do those dominantly successful in the stock market conduct their operations? Stock prices go up on buying and on nothing else. How do such interests buy? Do purchases of this sort take place under the guidance of those, who like the public speculators, *hope* the market will go up; or do they take place under the guidance of those who not only hope but who *intend* that the market shall go up?

Here we approach the question of what is called "manipulation" in Wall Street, "rigging the market" in London. It seems well at the outset to discard these two terms. Not only do the expressions in the minds of many connote moral judgments but there is a strong tendency to use the phrases more especially in those cases where stock prices are advanced to heights which

are justified neither by investment values nor by business prospects—where in fact the manipulation is definitely deceptive. For our purposes, we have not to single out market intentions, one from another. Nor is our discussion limited to attaining an understanding of how prominent stocks advance in price. What we want is to get a clear idea of how dominant interests act toward the market at all such times as they are active. Since our first question is, whether these interests act merely on hopes like the public or on definite intentions, let us see just how the public does act when it buys into a stock which it expects to advance in price.

There are certain times when there appears in speculative public circles a well-based impression that a certain stock is selling much below its investment worth. If the general market is strong, many public speculators wonder why the quiescent stock does not go up: "it ought to go up." During much of 1924-26 a similar general idea prevailed about the stocks of various of the great roads.

PUBLIC "FLOCKING"

It does occasionally happen that public participation takes place in a stock in which there is no control for the rise. A large amount of disjointed purchases by outside speculators, necessarily unknown personally to one another, may occur. Much stock passes into "weak hands" which hold it on margin through brokerage houses. When this occurs every Wall Street professional who has occasion to keep in

touch with the security in question, readily learns the true situation. It is only necessary to find out that no properly organized group for control exists, and that brokerage loans on the shares from the banks are rapidly growing. It must be plain that in such a situation no professionals would dream of touching the shares; for they would further stiffen the price and actually afford some of the public a chance to sell to them at a profit. It connotes no slander to say that this method of purchasing stock is not among the habitudes of these gentlemen.

Meanwhile, the public purchasers are growing impatient. "Why doesn't the stock go up?" That no one is buying heavily, that efficacious buying is absent, does not readily occur to the public speculator. (The reader must not forget that the transactions of stray semi-investors, of the specialist, of floor traders and of random speculators, will, at all times, make somewhat of a market in any well-known listed stock.) Time goes on and the impatience of our public grows; finally, one by one, at different times, they sell; and it is not improbable that most sell lower than they bought. A few may take a trifling profit, more come out about even, most are losers and all are disgusted.

Suppose that while such a heterogeneous mass of public buyers possesses the mass of speculative stock —certain powerful groups should desire its acquisition and be unwilling to wait for the public to unload in disappointment. What will happen? The reader may be certain that a "shake-out" will be engineered by short selling and rumors of disasters and prices depressed in consequence. In this case, our unfortunate public

speculators would sell the stock lower than they bought it, not only in disgust, but in anger and in positive bewilderment at the extraordinary decline of a stock worth plainly twenty or thirty dollars a share above its current price. Many would unquestionably dispose of their holdings with strong suspicions that "there's something the matter there"—some dark secret concerning the affairs of the apparently very prosperous corporation.

MEANING OF "ECONOMIC LAWS"

We have dwelt on this matter at some length, because the reader will never understand why and how prices move, unless he understands that they move under the direction of gainful motives in the minds of men of great intelligence and adequate wealth. The reader who insists that stocks cannot go up against "economic laws" is not asked to modify or abandon his view; he is merely asked to realize just exactly what he means by this opinion. For economic laws in the stock market are nothing but the expression, by means of buying and selling orders, of the human volitions which drive the market, actuated by the motives of gain and caution and conditioned by the amount of credit they can swing and by the distribution status of any particular stock whose shares they deem it well to buy. In a word, the economic laws conceived to be discernible in the stock market cannot be the laws of natural science; for nothing happens at all save when orders to buy and sell are given by human beings.

Let us now resume our inquiry as to the actual manner of action of those dominant in the market. Here we cease to do with inferences; we are concerned directly with matters of fact. How the interests who dominate the market trend do so, is to be solved by factual inquiry, not by logical reasoning. What follows on this subject is therefore based, not on inference nor on probabilities; it is based on observation of what does happen in this situation.

FORMATION OF OPERATING SYNDICATES

Except in certain exceptional instances, the really great capitalists of America, those who decisively make the trend of the market, do not habitually speculate in person. The same is true of various other able men of somewhat lesser financial caliber but who are, nevertheless, personally wealthy. These men are thoroughly aware of the danger which the stock market presents to anyone not trained for operating or who is not fitted by temperament for such work. When such men enter the market they do so not to take risks nor to expose themselves to needless mental strain; they do so, definitely and decisively, to make money. In this, as in other matters, their mode of action is about the converse of that of the public. For they retain, when they have not among themselves, some one experienced market director and they place the making and conduct of the market operation in a stock under his unified and unrestricted control.

Such action usually finds its market expression through what is called a "pool." The legal term is

"syndicate." When capitalists of the sort we are considering—those not "outsiders"—enter the market by placing their proposed commitments in a stock, under a market director, they do so with the primary intention of cleaning-up the floating supply or tying it up, and afterwards seeing that prices go to a figure where they can profitably dispose of their holdings. Such an arrangement, while it implies unified conduct of operations, does not always imply a legal contract with legal allotment of responsibility. There may be a legal syndicate; but, again, this syndicate may be the nucleus of a larger interested coterie whose members trail and *who are intended to trail, by the directing manager*. The association may be still looser, provided its structure be consistent with the attainment of its object.

One of the most usual informal methods is this: when the general market seems to be rising, brokerage houses interested in some stock of medium sized capitalization may ring each other up, have a talk about the amount of such stock each is carrying and agree to "keep it off the market" for a certain rise. Customers long of the stock are quietly informed. Now, it is not usual for even such customers, if they exist, to be told to buy more at the start. We have again and again spoken of cleaning up the floating supply and in previous pages in this chapter we have indicated how a group desiring a rise will shake out the public first of all, in order to get stock cheap. But in our present supposition, where the rise in this small stock is being engineered after the general market has started moving upwards, the situation is simpler, yet may be more

expensive. The stock is in fairly strong hands and the group must get this stock at as low a figure as possible. Now, in a small stock (five to fifteen millions capitalization or thereabouts), many orders to buy and to sell will be on the books of the specialist[1] and these orders must be wiped off. But the process must be handled with care; undoubtedly, the specialist will have orders to sell at advancing prices on his books. The group must get this stock away and do it carefully, for to let a man from this experienced body of stock market specialists know that a deliberate campaign to absorb the floating supply is in progress, may cause him to stiffen his prices, both for his customers and for himself, all around. In a certain process of this sort, the man in control of the cleaning-up told the writer that he had bought for two months "about 300 shares a day, so foxily that the specialist never once got wise."

DIFFERENT OBJECTIVES

To what extent the group arrangement must be legal in form and must approximate or take the form of a syndicate drawn by an attorney, depends partly on the amount of stock which must be taken on and financed. Moreover, there are initial differences in these upward stock movements. Is the main objective to sell stock already owned? Here there must be some sort of a legal arrangement if all misunderstandings are to be definitely avoided from the first. The stock is here pooled, the certificates being usually

[1] See J. E. Meeker, *The Work of the Stock Exchange*, pp. 106-128.

placed in actual physical control of the syndicate manager. Sometimes, before the public sale, the syndicate induces the formation of a second syndicate and induces this syndicate to buy the stock with the intention of offering the stock to the public later on. These syndicates used to be frequent at the inception of a corporation, whose stock given to the promoters it was desired to place among the public. The method has not been so much in evidence as it used to be in great corporations. Brokers who enter syndicates of this sort frequently find themselves in the unpleasant position of being tempted to advise their own customers to buy the shares for which they have a legal partial responsibility. Such syndicates invariably are formed with the legal understanding that such stock as has not been placed at a certain date must be taken up by the "underwriters" as the members, in this connection, are termed.

"TIPS"

But while it is necessary to refer shortly to the sort of syndicate just mentioned, the activities with which we are concerned are mainly market activities. We have taken the instance of an informal group composed to put up the price of a stock of a fair-sized corporation and we have seen how the manager must get the stock from the specialist which would be instantly dumped on him at higher prices, if he did not take this precaution to get it at low prices. Now, by examination and comparison for months, sometimes years back, by careful inquiries or by previous knowledge, the manager knows about when all the stock for

speculative sale outside of his own group, has been brought in or where it still exists. Now, it may prove that this floating supply is too extensive for the group readily to finance. Hence they must resort to tips among their friends to buy the stock. Great care and thorough knowledge of the situation are here requisite. For if tips are spread abroad and public buying begins which proves too scanty to finish the cleaning-up process or if the tips induce old holders to tighten their grip on the stock—and sell as soon as prices begin to rise smartly—the group we are considering may find itself in an unpleasant position. They cannot let the price sag, for the banks who are financing the move may decide to refuse further aid and may call loans when the bankers see prices unduly weak. In self-protection, then, the group is compelled to buy stock which it does not want, and the whole enterprise may come to grief and sometimes severe loss.

But generally managers of these groups know their business. It would merely confuse the reader to describe here a batch of complicated market tricks, which in stocks of these small corporations are much more frequent than in the market leaders. Let us say that the tips are well distributed and the time for their distribution well chosen. Notice that those who take *these* tips are intended by the group to make money just as the group members do. To some extent this intention arises from friendly relations but when the tip is broadcast, its promulgation is due to necessity. There must be a tie-up, if only for a week or so, of enough floating stock, so that the manager

can rush up the quoted price to a figure five, ten or fifteen points higher without meeting a bunch of offers to sell. When a stock does start on this spurt, the professionals of the Street and the floor traders all understand and they, too, buy heavily. Here the manager must move cautiously. For, if not, the price will soar so high that almost before he knows it, he will find himself confronted with a mass of stock offered by previous buyers who want profits, while stock will come in from all quarters of the compass belonging to amazed and delighted investors whose investment intentions have not been able to resist the lure of the ready gold in front of them for their shares.

When the market starts to go up generally, it is the stocks in the greatest industries, such as Steel, which move first. The controlling groups in these great stocks change their personnel slowly from year to year. One legal arrangement will be made, profits garnered and the syndicate dissolved only to be followed by a routine rearrangement. In these great stocks, when a syndicate operates, it often permits certain reliable friends outside of the group to get into the movement before the public tip goes out at all. In fact, the reader ought by this time to see clearly that while numerous tips are given out with the deliberate intention of selling the original stock to the public and closing the movement, others are given to help the tie-up of the stock. The distribution by the coterie at the top will, of course, be accompanied by all sorts of tipping but this distribution is possible, as a general rule, only because of the publicity which the rise has attracted to the stock. When the public rush in and buy at the

top, it is generally more true to say that they willfully and grossly deceive themselves by their unfounded hopes of high dividends, melons, etc., etc., than that the coterie actually has deceived them. In a word, a fresh tip, when the stock has not moved much, is sometimes useful to the recipient. To be sure, it is not fashionable to speak any more of such information as a "tip." It is called "market information." The word "tip," like "manipulation," "rigging," "pool" and "lambs," has succumbed to the preference for euphemism before facts.

STABILIZING CONTROL

The market control just discussed has for purpose a rise in price. But in various excellent stocks, this is not the purpose of the control or is the purpose only at rare intervals. Let us take an admirable example of this state of things. The floating supply in a stock like Pennsylvania is always quite small. It would be impossible, under ordinary circumstances, to purchase in one day a large amount of this stock in the open market without putting up the price, probably several or more points. In actual fact, the price remains steady and the stock moves gently and slowly in accord with the general market trend. The great interests dominant in this railroad do not want the investment character of this stock disturbed by ups and downs in the stock market. Hence, if the price advances a little too quickly on, let us say, even investment buying, stock is offered for sale and the market held in check. On the other hand, when the

entire market softens and a certain amount of selling either by a stray short or for long account, appears, offerings are taken freely and the price merely sags slowly and quietly in tune with the general market but at a much slower gait.

Not only the presence of market control but the actual financial need for such control in a vast market like that on the New York Stock Exchange, is shown in this great stock. For, if this stock were left without market sponsors, short sales would immediately appear to dash down the quotations a point or more, and the movement of the stock would begin shortly to approximate very closely to that of another stock which should be in the same investment class, but whose dominant interests have never been able to relinquish it entirely as an attractive market football, namely New York Central. Consistent, prearranged support to any great stock which may, by the size of its capitalization, tempt bears to sell with impunity (no danger of an immediate corner) is thus a real necessity which is faced by those who dominate corporations whose shares are listed. For years, the directors of the Lehigh Valley were most unwilling that this investment stock should be listed on the New York Stock Exchange and exposed to ups and downs unless they arranged definite control at all times. The subsequent action of this stock after listing, deserves a chapter to itself.

The detailed operations of a pool are sometimes very complex. Particularly, is this the case if the pool acts in consonance with some developments in the corporation itself, when a most complicated network

of finesse and intrigue may develop in the many negotiations between disparate interests which will run concurrently with the stock market operations. In these situations, sometimes the pool activities are directed not so much to immediate profits as to strengthening or obtaining part or whole control in the corporation. The profit motive refers now to a situation off the Exchange, in whole or in part (*see* Chapter VI).

PUBLICITY METHODS

Concurrent with the direct market handling of the situation, there is often a publicity campaign to influence the attitude of the public. Particularly must this latter work be attended to when the manipulation concerns stocks of great importance and huge capitalizations. A large amount of the public speculators like to have some apparently rational reasons for their purposes and not buy merely because they see a stock price is advancing or hear a plausible tip. Even those who depend more on the market appearance than anything else for their action, like to learn that the advancing stock movement is based on really good things to come. When a certain amount of investment buying is also desired by the sponsors of the upward movement, this impressionistic part of the program may require a degree and a kind of skill more adapted to the methods and practices of advertising agents than to the somewhat blunter methods of market operators. Many of the large corporations now have their own publicity staffs and when a great rise in the stock appears, this staff is kept

busy with sending out rosy reports and comments on the corporation. The personnel of these staffs have generally but faint ideas of how their propaganda is being silently correlated with the market operations.

One of the best examples of this sort of outside "influence" has been several times quoted but may be noticed again for lack of a better example. When the shares of the United States Steel Corporation were put on the market in 1901, those back of the vending cannot be said to have directly deceived the public. Yet they let the public as well as persons who do not usually consider themselves part of this group—get the impression that the shares would receive dividends straight on and that the earnings of the new corporation would be amply able to maintain the dividend rate. That "steel is prince or pauper" was not so well known to business men generally as it later on became. Nor were statistics in those days anything like as readily obtainable as now. That the Steel dividend would be maintained or could be maintained was probably believed by no insider in the new corporation, but their beliefs on the score were not communicated to the public. Only a flowery future was painted.

Whether shares intended for distribution are already owned by a group or whether they must first be bought affects the preliminary work of a manager but has not much to do with the final distribution to the public, as far as its technical phases are concerned. It should, however, be remarked that during its upward rise, a stock must be kept both strong and active. A stock whose prices move by single points or

even by half points and where transactions are relatively few in number means that brokers will deter those customers adventurous enough to want "to get aboard." Public orders will be executed by brokerage houses only on very large margins or where the stock is bought outright. Hence the sponsors of these movements have much less chance of success than they would have were the stock active as well as strong.

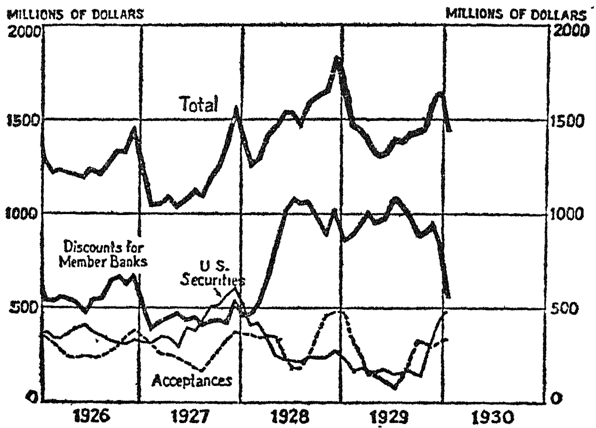
EXAMPLES OF STOCK MANIPULATION

Movements of this ultra-speculative character used to be much more in evidence on the New York Stock Exchange than now. They can be readily found at the present time on the New York curb market. On the Exchange, the stock prices of the American Ice Securities Company used to run up on decidedly scanty trading giving plain intimation that prices were the playthings of a close coterie. This skyrocket touched 97⅞ in December, 1906, and thence gyrated downwards to a trifle over 8 in the following year.

Such movements are not to be conceived as necessarily predicated on baseless rumors. Thus, the prices of Gulf States Steel, a prosperous independent company, have soared to the skies more than once; yet the advance has been pretty much based on good coming developments in the company. Moreover, some of the "rawest" and most reprehensible manipulations have been carried out well from a technical standpoint. More blatant speculation for the rise than in certain motor stocks in 1925 has probably not occurred since the foisting of Amalgamated Copper

shares on the public in 1901. Naturally, in the following bear reactions these balloons were smashed to bits.

In the years preceding 1910, there were various stocks in which speculative coteries would each accumulate a line and then run up the price, fifteen or twenty points, and sell to the public. The price then



RESERVE BANK CREDIT (MONTHLY AVERAGES OF DAILY FIGURES FOR TWELVE FEDERAL RESERVE BANKS, 1926-1930; LATEST FIGURES ARE AVERAGES OF FIRST NINETEEN DAYS OF JANUARY)

fell back and the process was resumed the following year. It will be observed that these price swings were more or less reasonable. Sometimes the distribution was in the year following the accumulation. Such stocks as American Sugar Refining, Brooklyn Rapid Transit and certain leather shares were distinguished in these operations. But it is not meant to criticize adversely these movements: the man who is not willing

to accept the "game" of the market should not speculate at all; no one bids him enter except his own ambitious motives.

Nor must the impression be left that every upward movement in a stock—every manipulation,—leaves the public buyer with stock too highly priced from an investment standpoint. Often this is not so; the wisest pool managers prefer to sell at figures not far off from values as computed on a good investment security. The popularity of Union Pacific as a market leader when Harriman lived was due a good deal to the fact, that no matter what surprises were sprung by that astonishing group which he headed, they always pulled a real melon out of the bag in the end. In general, the same things might be said of the United States Steel shares in the last few years.

SPECIAL MOVEMENTS AND THE GENERAL MARKET MOVEMENT

Generally speaking, speculative movements for the rise are most successful in a general bull market. The market, as has been often said, moves pretty much as a unit, though some prices move fast, others slowly and others mark time. While many stocks have their own special movements, yet few are apt to move successfully when they move very much "out-of-line" for an extended period.

While the aim of a pool is to sell at the top of the advance, sometimes this is not possible. The general market may soften and begin to decline. Still, the pool may come out even because of the incorrigible fancy of

many speculators for buying "on recessions," on the commercial idea that if the stock is a good buy at 100 it must be a still better buy at 90. It has been thought in some well-informed quarters that most pool selling is done on the decline of the general market. But it should be plain that the time of sale depends on many circumstances and no one knows what the general facts are, for pools do not make public statistical tables. It seems more consonant with the facts which can be observed to say, that late pools in a bull market probably have to sell partly in declines, if successful at all, while the earlier pools, when not too greedy, got out in ample time to avoid any downward dashes in the market.

The reader will notice that we have not spoken of "wash sales" or "matched orders," two things which bank large in the minds of politicians. "Wash sales," the deliberate false buying and selling between two brokers, appear extinct. "Matched sales" means that an operator gives simultaneous orders, one order to buy a certain amount of stock, the other order to sell the same amount of stock, to two different brokers. The brokers who are, of course, innocent parties, therefore effect a sale where no stock really changes ownership. The net result is merely added activity to the market for this stock. A large amount of such matched orders would produce "churning" where the stock seems intensely active but makes no headway. Probably, such orders are used from time to time, though, unless precisely simultaneous, they are not illegal. If it be granted that it is right to put up the price of a stock and sell it to the public, to signal out

this particular method of action for reprobation seems curious.

MANIPULATION IN THE CURB MARKET

The reader may be interested to learn what happens when banking restraint is more or less absent, as will happen when stocks with little or no collateral value, are driven upwards in price. In these cases, the pool concerned, not being able to borrow on the shares, will be obliged to put the price far up, to derive substantial profits from the sale of the relatively few shares which they are able to carry. Such flights have been witnessed again and again on the New York curb, both in its old quarters and, possibly, to a lesser degree, in its new. Generally speaking, stocks of rather small capitalizations have been involved. It will be noticed that in the case of stocks with no collateral value, the floating supply cannot be well distinguished from the fixed supply except by the personal factor of the owners' intentions. Those who own the stock outright are usually pleased to see it rise in price and may concur with the manipulators, by refraining from selling till after a large advance. But if they do sell ahead of the pool, the fate of the latter is obvious. A thorough study of these whirls in the Curb market may be remitted to a specialist in that field.

The reader is asked to fix definitely in mind that the presence of dominant group action in a bull market does not involve any necessary conclusion as to why its members deemed the time appropriate for market action. The pool members may believe that they are adjusting prices to values in the future and these

values they may quite correctly foresee. Or, they may be more or less ignorant of such future values or they may care nothing about the matter at all so long as they think the public will be in a mood to buy when they are ready to sell. It is idle to blink the mind to the fact that the profit motive and the motive of caution are, as we have said, the dominant motives. The discussion here aims merely to specify the form of the activity naturally and sensibly assumed by those who make the trend of rising prices.

All the preceding remarks about manipulation apply to the bull side of the market. The short side of the market does not attract the public and the existence of pools for the decline is almost unheard of. Even speculation itself by the shorts cannot be said to dominate a bear market. Necessity is there the controlling factor. But the characteristics of bear markets previously discussed (Chapter IV) need here no further elaboration.

The reader may wonder about the identity of those who buy and sell and make the market when things are quiet and the commission houses contain few speculators in their rooms. The answer is simply that the floor traders, the specialists on the Board, the professionals and semi-professionals and the occasional lambs who at all times may be found, buy and sell to each other—and the market hardly moves. Why should it?

PUBLIC DISINCLINATION TO FACE FACTS

One further remark may fitly terminate the discussion of this subject. We have noted the deep disincli-

nation of various writers, especially those who have never or rarely speculated or who have connections with investment houses to admit the predominance of controlled market rises in prices. A mass of heterogeneous, unconnected buying which in some utterly unexplained manner puts up prices is their conception —a conception very hard to criticize because it is never expressed with exactitude in the details. The unwillingness of investment men to face the facts is sometimes based on real nescience, at other times on a deep distaste for a consideration which inevitably lessens the effect of certain of their selling points. But there seems to be a more deepseated reason for the unwillingness in other cases. Public observers and speculators alike do not care to think that they are being "used" for others to profit thereby; nor that their gains when they make them, are not due to their intelligent "investigation" but to the fact that they have trailed those financially powerful and aware of the public's chronic cupidity.

As far as possible let us apply the above considerations to the condition of the stocks listed on the New York Stock Exchange. Of the 1280 stocks, those not cleared may be said at once to show by the fact of their inactivity that they are not under control for the rise. This, however, does not at all mean that the shares are under no sort of market control: probably in every stock on the Exchange there is the minimum of market control in existence, that, namely, which consists in supporting the stock, up and down, by placing a certain number of buying and selling orders with the specialist. On a small scale, it is like what we

find in Pennsylvania. So far from there being moral obliquity in this state of things, the exact contrary is the case. The directors of a company who brought out a listing of a stock on a vast market like the New York Stock Exchange and then left the stock utterly alone, with no regard or knowledge as to what pool or what individuals might do to the price—such men would act in a manner reprehensible; and, if a stock, under such conditions, began to display violent antics, the Governors of the Board might very reasonably inquire into the odd state of things. Sometimes large stockholders, not on the directorate, exercise the control.

HOW A STOCK IS LISTED ON THE EXCHANGE

Much of the misapprehension about the normal and necessary feature of market control in any listed stock comes from a vague idea that the "Exchange puts them on the list." This idea fails to note that the company itself has to apply for the listing of the shares. When application to list a stock is made, there must be filed with the Committee on Stock List, among many other papers, a copy of resolutions of stockholders, board of directors or executive committee, attested by an executive officer of the corporation, authorizing some official, personally and by name, to appear for listing. Of this officer a number of questions regarding the technical status of the shares are asked and must be answered in writing. Thus, he is asked whether a syndicate exists or whether the holdings are concentrated or whether any blocks are under selling restraint (as by previous agreement). Then he is required to

give a classified summary of the list of stockholders, showing how many shares are held in lots of various sizes; and he must state the amounts of the ten highest holdings and whether all stock is or is not, free for sale.

This does not at all mean that the New York Stock Exchange objects to the existence of a syndicate in the stock generally; but, as already stated, it does object to a syndicate which is to vend very strongly concentrated holdings as soon as the stock is listed. In other words, the New York Stock Exchange does not care to offer the primary distribution market for shares; and this situation alike discourages speculative behavior *based on such premises,* and encourages proper market control in the shares, so that transactions do not take place at wild and disquieting price gaps.

Of the mass of stock which is cleared it may be shortly said that wherever any stock is so active that it comes within this group and where there is no coterie, the conclusion of all sensible well-informed observers is that there should be one. The public idea, which, strangely enough, coincides with a sort of pseudo-academic idea, that stocks are safest to buy when no pool or coterie handles their rise, is a singular inversion of the truth; though, as we have pointed out, there are considerations which tend to make certain observers unwilling to admit this constant and all-pervading market control in the stock market. Let us go further; not only does control exist, varying from mere stabilizing to the "rigging" of rises, both justified and unjustified, but almost each stock has its

own special little market, its own way of moving which in some indescribable way is a sort of market transcription of the characteristics of its market sponsors. One type of speculator "likes" one stock—there seems a sort of intelligibility in its movements. Another finds that stock's movements are a mystery, and that a second stock behaves much more in a rational way. And so we might go through stock after stock on the list.

CHAPTER IX

PROFESSIONAL OPERATIONS

The mention of successful concerted groups and their directors, does not exhaust the list of those on the right side of the market. The professionals when acting on their own account, and the semi-professionals must not be left out of account. By professionals is meant those who, in general, follow stock exchange speculation as a vocation. By semi-professionals is meant, in a rather looser way, those who, though often fit by temperament to become speculators, nevertheless extend their financial operations to include promotions, reorganizations, speculation in foreign exchange, etc., or who have, sometimes, some other business, more or less nominal or real, to which they may pay routine attention or leave under the direction of some lieutenant.

The most important group, by all odds, used to be the three or four hundred members of the New York Stock Exchange known as "floor traders." These men were scalpers—that is, they chased the small fluctuations of the market and usually cleaned up their trades on the same day on which the trades were opened. These floor traders were usually supposed, therefore, to have no financial worries on their minds over night.

At present, this group has greatly diminished in number and is now estimated to be no more than about

forty or fifty. The reason for their diminution put forth by the economist of the Exchange is doubtless a main reason for their lessened number. These men were constantly in and out of the market, taking a profit whenever offered. It would seem as though the bulk of their business consisted in turns of the smallest sort. Indeed, a popular phrase used to describe them as "chasing eighths." Of course, they could only hope to make money on the balance of their trades. It seems that the Federal and State taxes, each of $2 per 100 shares sold, have been too much when placed against the $12.50 (one-eighth) profit sought for on their trades. The pressure on this group by short-sighted political action has not had a good effect on the mechanism of market exchange. Their constant ins and outs of the market used to insure continuity in price range of many stocks, even in inactive times.

OVER-THE-WIRE TRADERS

There is another class of professionals of whom the public is almost entirely ignorant, but which is becoming more important from year to year. Reference is made to the employed traders in various large houses. These men do not, as a rule, deal in stocks which are listed on the Exchange. They deal, with the use of their employers' funds, in those stocks which are termed "outside securities" and which are bought and sold "over the counter," as it is called. Many important stocks are included in this class, especially stocks of those corporations which, for one reason or another, do not give sufficient information about them-

selves to the New York Stock Exchange, to be admitted to the list.

Professionals of this sort are, of course, salaried men. They get generally from $5,000 up to $12,000 or $15,-000 according to their dexterity and success in trading with other houses over the telephone. Usually, these traders sit in a private room. A single house may employ one such trader or it may support four or five or even more. Beside each trader is a collection of telephones, often as many as twenty-five or thirty at each man's desk, each wire leading directly to some other house where similar trading is conducted. A private switchboard is also usually in the room, so that houses not connected by private wire, can, if necessary, be reached without any unnecessary delays.

The sight of one of these rooms on an active trading day is most curious. The ceaseless calling up and answering, the quick buying and selling makes a sort of miniature stock exchange before the visitor's eyes. The problem before each trader is, of course, to sell what he has bought of one house as soon as may be, to another house at a slight advance in price. In an upward movement, every trading house may make money, as the shares may pass from hand to hand, just as listed shares may do, at constantly advancing prices. It is when the market slackens its gait or makes a turn that the caliber of the trader is shown, and the firm has to decide very quickly whether to retain his services or to discharge him before he has lost any considerable amount of its funds.

Lest it should be imagined that stock speculation must, after all, be a fairly easy profession if the trick

be once acquired, let it be said at once that whenever one of these highly salaried traders becomes so vain of his activities that he starts a business of his own, he has, in every single instance which has come to the present writer's attention, been unsuccessful. Dealing with an employer's funds and dealing with one's own funds are immensely different; the one is a comfortable occupation even when the closest attention is needed, the other is nerve-wracking. A close study of this method of trading by those with several years' experience would, however, be of interest. In a study limited to the open market, these activities can merely be mentioned as illustrating how extraordinarily wide of the mark is the statement that success in speculation is impossible. Unless they are public personages, such as the late James R. Keene, successful speculators are very little known.

TRAITS OF PROFESSIONALS

We must now, however, glance more closely at the professional who trades successfully "on his own." To be of any value this study must be based on definite observations. The men who are brought in contact with these great operators are usually the partners in the New York Stock Exchange house with which they deal. But the managers in the customers' room have, of course, the right (and, in fact, the duty) to inspect the accounts from day to day. If the house be a very wealthy establishment, the men in such positions are enabled to see at first hand as much of a professional speculator's operations as he is obliged to reveal in

order to transact his business; and, if they have had long experience or if their observations are aided by the members of the firm they may be able to see a good deal.

The three following sketches are taken from life. The writer has selected these operators' methods for description, first, because the incidents are over twenty years old, secondly, because the firm has long since dissolved and, finally, because all of the men concerned are dead. It may be said that the three accounts which we shall now briefly review, are in many ways typical. Great operators have, in general, certain traits more or less in common—broadness of economic vision, correlation of action with foresight, observation of what means nothing to others, a tendency to reticence (except on rare occasions where human vanity shows its head) and a certain rather pronounced indifference to the means used to attain success.

TRAILING A POOL

The period over which I watched the accounts of these operators extended about two years. One of the men never entered the office during that period but transacted all his dealings over a private wire; a second, a great corporate magnate, was not infrequently in evidence. He had come up from the ranks, or so it was said. Dressed a good deal beyond the limit, this old fellow really resembled, for all his acquired dignity, a prosperous brakeman. His speculation was entirely and with no exception in the shares of his own corporation, when that was under market control

(manipulation). In other words, *he trailed the pool of which he was a member*. As his dealings ran from 5,000 to 10,000 shares open at a time, it is incredible that the pool manager did not know of his operations but, from various other considerations, it would seem that the stock in this great company was run up and down on the board through control emanating from a consensus of several magnates rather than from the unique direction of the manager who actually distributed the orders. While the operator here discussed was uniformly successful, it is uncertain how much of his success depended on his own mental processes and how much on merely intelligent, faithful imitation.

Here, parenthetically, may be noticed what the reader has possibly been aware of during his attention to the preceding chapter on manipulation. The actual course of a manipulation not only differs because of the personal character of the pool leaders and the environment of the shares, but it may differ because of circumstances concerning which no definite knowledge can be given except by the very men who are themselves in control of the stock movement. In certain instances, where complications arise from connection with political leaders, situations of the most curious character are in evidence to those behind the scenes. Certain of the maneuvers on the Philadelphia Stock Exchange have been based on factors which the public could never have guessed and which could not have been divined by the most attentive expert without more than the information which seeps through to the press. The successful speculator who is concerned with a trade in a corporation which he may

think to have political relations finds he must undertake an investigation into matters which fall outside of strictly financial factors.

Another of the three successful professionals referred to, belonged to an old and a well-thought-of New York family. This man *speculated for a long-time pull on long-time considerations.* To the outsider who could have observed his trades, his method would have seemed merely that, so often recommended, (and usually so disastrous) namely, buy a good stock and "sit on it." What the outsider might not have noticed would have been the fact that he bought the good stock at the right time and kept out of the market entirely at other times. The method is psychologically impossible to nearly all traders, even when they have the intelligence to discern the right moment to buy and the even rarer self-control needed to keep sometimes entirely out of the market, though constantly watching it. This man did not take on his whole line at once, but once the line was taken on, he held it. Of course, a full study of his operations would have needed an observation period of more than two years.

SCALPING FROM OFF-THE-BOARD

The third man was the true professional. Though he had nominally another business, his entire time seemed actually taken up by his exchange operations. He had his own office ticker. Owing to the increase in the commission rates, it is more than doubtful whether his invariable or almost invariable method could be employed today. *His method was to scalp the market*

on those stocks where the market was always close and where the activity was great. In other words, his method compelled him to confine his dealings almost exclusively to the market leaders. He thus essayed and succeeded in the extremely difficult task of scalping the day's fluctuations, although he was not personally a floor trader on the New York Stock Exchange. His trades were invariably in blocks,—that is, his minimum unit was 1,000 shares. In order to make it difficult to follow his trading and to discern his real position in the market, he employed, in all, six of the great Exchange houses, buying of one house, ordering the shares transferred to a second, selling in a third and having the stock delivered from a fourth. Of course, his procedure was not uniform. At times he sold where he bought; at times, he involved his trades in a whirlpool of transfers. The net result of this maneuvering was that, though his connections and his actual line could not be very well concealed, yet his real monetary power in the stock market was involved in a haze. "It is impossible to tell whether that man is really wealthy or not," remarked one of the stock exchange members who saw his accounts and who was of the firm in one of his numerous brokerage houses. Later events left no doubt on this point.

If the market went his way, this trader would usually sell the same day, as far as could be ascertained from the entanglement in which he kept his various accounts. He strove, just like the floor traders of his time, for an accumulation of many fractions. But if the market was very active and the tape at all behind the market, he might be handicapped in his

actions. On this account (and in few things could his perspicacity have been better displayed) he rarely sold at the close, because the fractional variation is often at that moment too sharp to give an order which may depend on an eighth or a quarter for success or loss. His deals were mostly all between half past ten and a few minutes after two o'clock.

A PROFESSIONAL'S TECHNIQUE

On one occasion, for nearly two months this operator took minute losses day by day which on the books in the single office where the present writer was engaged, aggregated about $75,000. He then boldly and rapidly recuperated his losses and was soon well ahead. It will be noticed that this man was handicapped not only by his total commission of one quarter point, but by the fact that, perfect as were his connections and carefully thought out as was every detail of the machinery of his trading, it was still impossible for him to bring about an instant execution of an order. Normally, the tape is about fifteen to twenty seconds behind the time when word from the broker reaches the official stock exchange telegrapher on the W.U. wires. But the messenger on the exchange to the telegrapher is behind the time of the actual sale contract between the buying and selling brokers, by about an average of half a minute.

Thus, at the best, when the operator here noticed saw his tape, the last sale was about a minute behind time. Of course, he traded on the obvious immediate trend, but this consideration nevertheless meant that

he could not be sure of the instant rate of the stock's advance. Now, it took him probably fifteen seconds to get his order to the broker and another fifteen seconds to a half minute before his order could be wired to the floor of the board and the trade put through. It seems impossible not to admit that he was always subject to a minimum handicap of at least two minutes. The same delay might occur when he attempted to sell. Therefore, *he sold when the market was still rising.*

That, in spite of all these considerations, this man was a large and consistent winner reveals a market dexterity of the highest excellence. It might be well to add that this operator did not exclusively confine himself to scalping. In a very few instances where he had information of the closest sort, he executed some praiseworthy long-time speculations. This, however, was not his customary forte. The advance, years later, in the commission rates must have compelled him to abandon scalping operations, and as to what his further activities in the market were the present writer has no first-hand information.

THE FINANCIAL EXPERTS

An account of the personnel of those engaged in the activities of the New York Stock Exchange would be quite incomplete which did not consider the action of the real financial experts of America. This class includes various men connected with banking houses or with drawers of foreign exchange, a certain number of brokers and perhaps twenty-five or thirty professional

analysts. The rather numerous employees who accumulate statistics for others are, of course, not included, nor are those whose knowledge of the Street is second hand. In general, it may be said that many of these experts prefer to make their money in the more complicated but more certain activities connected with promotions, mergers, reorganizations, etc. We have already noticed, under the title of Corporate Control (Chapter VI), the close connection between corporate conditions at such junctures and the market conditions. The scope of this book does not allow further consideration of this subject.

Confining ourselves, then, to the actual speculators who are at the same time experts in finance, it may be noted that we have here a class which, in general, consists neither of heavy winners or of losers if the course of years be taken into account. These men have learned to cut losses but not always to accumulate their profits. As long as they speculate for others under power of attorney, they are likely to be winners for their principals. But when they stake their own funds and deliberately expose themselves to the strain which is invariably engendered in those who not only open an account but who guide their accounts on the summing up of what they really know and of what they are merely probably sure,—at these times they are not generally so successful. One of the very best advisers in the stock market during the last twenty years has been seriously mistaken when he has undertaken to follow his own advice. Two others who are nationally well known on financial matters outside of speculation have contended that no one makes in the market—their

own efforts having been futile, despite their large knowledge and good connections available for information. The psychological factors which militate against success with these men as with every one else will be examined in detail presently. But as men of this sort are nearly always successful in the handling of speculative accounts for others, the reader may be interested to learn why this action does not yield them large gains.

DISCRETIONARY ACCOUNTS

The expert who handles a discretionary account in Wall Street for a principal is, in theory, exactly in the same position as the manager of a pool for a group of capitalists. The only immediately obvious difference is that the expert handles accounts of a much smaller size than the manager of the pool—sums varying from a few thousands up to ten or fifteen thousand. Thomas W. Lawson at one time conducted a pool—unsuccessfully in this instance—where the smallest unit was $25,000. In general, however, men large enough to place more than ten or fifteen thousands at stake seem not to care to entrust their funds to other than men of equal financial rating. Hence the expert here deals usually with men of medium-sized monetary capabilities and who realize that they, themselves, are not well fitted for speculation.

Now, in the last analysis, the surprising fact seems certain from observation and experience that financial experts who handle discretionary accounts do not consistently succeed because they cannot consistently retain the same man's account; and they cannot retain

his account because invariably, when he finds his agent is making money for him in speculation, he slowly or quickly comes to the conclusion that he could just as well have made the money himself and saved the operator's commission (usually 30 per cent). As the principal has not concrete knowledge of the necessity of avoiding many "good things" in order to speculate with as close an approach to certainty as is humanly possible, he will observe that the operator has passed by opportunities for trading which, in actual fact, if embraced, would have netted profits. That the operator is chronically afraid of "good things" from long and bitter experience, he does not fully realize. In a word, discretionary accounts are rarely kept by the same operator for lengthy periods because the principal cannot resist concluding that he could just as well have tapped this stream of gold himself.

It will be observed that the principal who puts up $10,000 merely affords the operator, when he succeeds, an income equal to trades on $3,000, if the commission is 30 per cent. Actually, nearly all principals want to bargain over the commission, not realizing that unless a real incentive is allowed the operator his interest becomes perfunctory of necessity. The operator who has handled discretionary accounts knows that he is unfair not only to himself but even to the principal himself if he takes accounts which cannot bring in a worthwhile percentage of profit on the amount placed in the broker's hands. Similarly, the operator who gives a portion or agrees to give a portion of a commission of the account to a third party (for the introduction, for example) makes himself liable to press the account too

hard. If, under these circumstances, he incurs loss instead of gain for his principal, he exposes himself to the likelihood not only of a merited rebuke from the loser but of—what is worse—reproaches from himself for his lack of foresight. Accounts that are brought by a third party to an operator should be paid for or otherwise settled at once. No principal should entrust a discretionary account to any operator without inquiring whether any one else has a claim against the winnings.

For the interest of those unacquainted with the matter, a brief description of how these discretionary accounts are usually conducted may be of interest. The principal deposits, let us say, $5,000, with a brokerage house and gives to the speculator who is to operate for him a power of attorney to buy or sell against this deposit of $5,000. The power to withdraw any moneys is retained by the owner and no reputable operator will handle an account, under any ordinary circumstances, which does not contain this provision. If successful, the operator draws down his commission at stated times, usually once a month, when the account is balanced at the brokerage house. The operator should always take out his commission then and there or confusion and misunderstanding may, later on, result. If the owner has lost during the month, he very frequently wants the operator to recoup this loss before any commission is paid to the latter. Not a few speculative traders offer to do this. But it is altogether much wiser that no such arrangement be made, for, as the speculator cannot gain a cent unless he makes money for his principal, he is certainly already doing

the best in him. To ask him, in effect, to give a semi-guarantee of his work or to try to charge losses against his future winnings is merely putting a handicap in his path. Each month's trading should stand entirely on its own basis and if the owner feels that the operator is not handling the account satisfactorily, he should withdraw the account and cancel in writing the power of attorney. Every broker that the present writer knows requires that the principal give these powers of attorney in writing and cancel them in writing and will allow no such accounts in other ways. Various brokerage houses have their own printed forms which must be signed by the principal. In this way, every one concerned, broker, principal and operator has his duties and rights set down in black and white and the apportionment of loss and gain between the principal and operator is clearly understood before the brokerage house as witness.

CHAPTER X

SPECULATIVE TACTICS

In this chapter it is proposed to consider in some detail the errors and omissions which an observation and experience of some twenty years have shown to be actually detrimental to the success of those in the market. Naturally, without mature intelligence success can hardly be expected under any considerations in the stock market. But some do win who, from the amount of their knowledge of things financial, might be supposed likely to be chronic losers. In the following chapter, we shall notice the underlying defects of temperament and personality which may make the ablest expert fail to win any worthwhile pecuniary success.

Nothing is more obvious about the market than that it must go, for any length of time, either up or down. The most natural tendency in dealing with the market is, therefore, to take advantage of this apparent 50 per cent chance of winning and enhance it by a little skill. This is the real idea underlying most every scheme to "beat the market." Moreover, if a loss is sustained on the first attempt, it is not necessary to double the commitment. There is a plan which has been published much more than once in Wall Street whereby a slight increase of the capital at stake ought to suffice to win back the original small loss and show a small gain.

Small commitments of the original size are then recommenced till a loss is again sustained, when the process is repeated.

GAMBLING METHODS INAPPLICABLE

Although this method is more suited for roulette than for stock speculation, it is applicable to the latter. But in actual life such a plan requires so much patience, assiduity and persistence in sticking to a chosen course as to be beyond the ordinary capabilities of human nature. Moreover, such a method will lead to but quite small winnings, unless the capital at the start is very considerable. Further, a gambling method of this sort, which tries the patience but a few hours at the gaming table, may involve days and weeks for its proper execution in the market.

Since the market can go only up or down, a speculator who chose his stock at hazard and bought and sold at hazard, should have an even chance of profit and loss in the long run. The usual "methods" for winning in the market are based, openly or tacitly, on this fact; they assume that the fifty-fifty chance may be at least slightly turned in the speculator's favor by the addition of a small degree of skill at obvious points. Unfortunately, the instant skill is superadded, the chances are hopelessly confused. The outsider chooses his stock and his time to buy, as well as whether he should buy in the first place, rather than go short of the shares. It is plain that if he acted on the toss of a coin, he would sell short as often as he buys long; but he hardly ever sells short. Thus, at the very start, he halves his own chances. Moreover, in choosing his

stock, and his time to buy and to sell, he still further diminishes his probabilities of success.

WHY THE PUBLIC BUY

The public speculator buys, as already noted, almost entirely for two reasons; either he has a "good tip" or he sees the price going up before his eyes. The question of when a tip should be accepted has been pretty well discussed and nothing new is to be added. But when the speculator sees the stock rise, he usually waits a while to "make sure." Such rises are generally the "spurt" upwards made by a pool's activities after its line has been accumulated. The pool does not wish the public to buy as soon as the "stock starts up," and this wish dovetails neatly into the speculator's hesitancy. The further the rise and the stronger the movement looks, the more he is tempted to buy. Finally, he buys, if not at the top of the advance yet dangerously near to the top. He has hoped when he should fear, and feared when he should hope. For, almost always either he should have got aboard as soon as the stock started off or he should have let the move alone. He has, in fact, fallen a victim to what has well been called the "innately deceptive appearance of the market"—its apparent proneness to a still further advance when the advance is, in fact, just about over.

But while a speculator's decision to buy a certain stock is usually based on tip or sight of actual rise, the number of speculators among the public who like to confirm a belief in a stock's desirability by an "investigation" has plainly increased. The public has been

urged to become familiar with the balance sheet and earnings statement of a company. Now, it is not impossible that a stock may be undervalued for a considerable time and that its true value may be "writ large" in its basic statements. But it is not so infrequent, when the balance sheet and income statement of a company seem to indicate decisively that its shares are undervalued, that "something is the matter." For example, in the early part of 1928 as well as during 1927, the shares of the American Telegraph & Cable Company, leased to the Western Union, have been quoted at around 25 to 30 or thereabouts. The shares are 5 per cent and at $25 a share, obviously yield 20 per cent on the purchase. It may safely be assumed that this stock has been bought by various public speculators, as a "neglected issue"—for the stock is not wholly inactive, and some one or other has been willing to supply shares for sale. The reason for the low price is that the lease expires in 1932 and will hardly be renewed, as the old cable is considered lacking in modern improvements.

Another leased line of the W.U., the Northwestern Telegraph, has paid about 6 per cent on the purchase, for it sells at a trifle over $50 a share and pays a $3 dividend. The lease expires in 1980 and the yield computed to maturity would be 5.85 per cent instead of 6 per cent. This stock, whose price is probably too low has, however, been quite neglected, there being next to no market in it. On the other hand, if we revert to 1906, we will find that the desperate conditions of the Missouri Pacific were known in various Wall Street circles. Yet the stock did not promptly register this

knowledge, probably because the room traders on the exchange, then 300 or 400 in number, feared a corner, were the shares sold short extensively.

INVESTIGATING A STOCK

But, aside from the fact that the balance sheet and earnings statement may reveal neither the decisive points for good or for bad, it is well to stress the fact that this sort of financial investigation is not adequate in most instances as a basis for market action. When the value of a stock can be gauged by this examination and by nothing further, it is usually true that the value is well-known to any one in the Street who is interested in the corporation.

In actual fact, when the affairs of a company are in doubt, the most that a financial investigation can do is usually to indicate sources for further inquiry. Thus, a large extension of liquid liabilities would at once suggest to any one versed in Wall Street that the identity of the banks extending these credits should be ascertained and the attitude of their executives toward the executives and directors of the corporation should be checked up. An outside speculator never thinks of such things. But, further, to "get to the bottom" of a corporate situation, reports are needed from engineering experts and from certified public accountants. Moreover, when all such information is in, when it is ascertained that the conduct of the company's operations is efficient and honest, the problems of its buying and selling remain for consideration. And, of all corporate problems about which a veil may be thrown by execu-

tives and directors unwilling to give out the facts, that concerning the buying end of the corporation is preeminent. The basic reasons why a certain corporation pays too much for its raw material may sometimes be obscure to the buyers for the corporation themselves, particularly if the raw material has no open market. Often the business investigation of a company is simply impossible to conduct to a satisfactory end without authority from the courts to inspect the books. Yet, the average outside speculator imagines, by reading a so-called "analysis" printed in a big and expensive volume, that he is making an "investigation"!

But, now, let us suppose that the speculator has good reason to judge that the shares of a company are undervalued, and, hence, good reason to buy. Such a situation is not unknown at all; sometimes long periods elapse before the true value of a stock is recognized by the market quotation. What does such a speculator usually do? The answer is, that he buys some of the stock. Here it is plain that he is doing just what numerous public speculators do at certain junctures, and which was discussed in detail previously (pp. 102-3). Much as he would deny it, the speculator who acts thus is really asserting by his market action that he is buying into a stock which has conveniently waited for him to purchase it before moving upwards! He is a victim of the delusion that *because* a stock is low, *therefore* it must go up. Whereas, the only thing that puts a stock up is buying, and the only thing that puts it up "high," as the speculator fancies it will inevitably move, is directed buying.

SPECULATION BASED ON INVESTMENT CONSIDERATIONS

Is it possible to lay the finger on the precise spot where our speculator has erred? Yes; he has bought stock for a relatively short-time speculation on the basis of long-time considerations. We might almost say that he is reasoning as an investor while acting as a speculator. Plainly, when he buys he has no intention to tie himself up for a year or more; yet, as far as his investigations go, he has let himself in quite readily for that possibility. If the stock does go up soon after his purchase, he has nothing but luck to thank. The real questions for him to consider, whether a capable pool exists and what it intends to do, he either does not consider or passes up as impossible of solution (which, sometimes, they are). Nor, does he correlate the point, whether a pool is in existence with the point, whether the general market is in a condition,—a bullish condition—which will permit successful operations by a pool.

In the leaders of the market, it is not necessary to inquire about the personnel or the resources of a pool; the question is, Whether it is in operation. In these shares the personnel and wealth devoted to pool activities are so huge, that interesting and even useful as detailed knowledge may be, it is not essential. The market movements of the stock at present and at similar junctures in the past are readily revealed by good charts. A speculator should use these charts, not because of any mysterious qualities, but because they supply any instant bird's-eye view of facts impossible to remember in their entirety.

If we turn to the mistakes made habitually by outside speculators at the beginning of a trade, we shall find that choosing the wrong time to buy has often another disastrous implication. The speculator who buys into a stock which, on values, ought to go up, may proceed if it go down, to "average" by buying on a scale down. This pernicious habit is frequently recommended by those who have been in the market little or never. In theory, it is plain that if a stock is cheap at par, it must be cheaper at 90 and so on, down. Hence the speculator, it is said, should hold on and buy more, as the price goes down. That this process may tie him up for a long period is already evident. But it may do worse. It may seriously deplete his capital, for the stock may go very far down. And most important of all, it may upset his judgment to such an extent that he becomes incapable of acting along any settled course. It is a very curious fact that when a man has carried a sinking stock for a very long time and when at last it does rise, he very frequently sells at his original buying point plus his interest and commission charges, glad beyond words "to get out even!" At the risk of repetition, attention again must be called to the fact that, just as in buying the shares originally he was carried away by his hopes, so, now, in prematurely selling them, he is carried away by his fears.

Let us use another instance to illustrate the downright bewilderment of the public speculator. Suppose he buys a stock, and in a short time the price goes up five or six points. Should he take his profit? Here he is torn with doubt. He has heard the old maxim: "Limit your losses and let your profits run," but he has also

heard "Never forego a profit." It will be found that the correct answer is bound up with the other two questions, what stock to buy and when to buy. No knowledge of values or lack of values is going to be of any particular use at this juncture. But the answer will appear more convincingly if it is allowed to appear, almost of itself, from various points which we have still to develop. Let us leave it here for the moment, and turn to some other matters.

THE SPECULATOR SHOULD AWAIT A DEFINITE MARKET

The character of all markets is not obvious. To be sure, no one can mistake the bull character of such markets as 1908, 1915, early 1919, 1921-22 or the market of 1924 onwards. On the other hand, the entire period between the middle of 1909 and the closing of the Exchange on July 31st, 1914, presented a difficult, because too narrow or partly ambiguous, market for the speculator. Even 1912, which in retrospect appears as a mild sort of bull market, was not so well defined to those participating at that time. In years when the market's character is not clear or when its up-and-down movements are narrow, it is wiser for an outsider to keep out. Even the best professional cannot do much in such markets. There is a great contrast between the ease with which money can be made in some years in the stock market and the ease with which it may be dropped in other years. A man who had gathered from bitter experience a very unflattering opinion of the market of 1916, remarked in the writer's hearing that "Any damn fool could make money in 1915." More

recently, most of 1918, part of 1921, were hard periods in which to speculate. The markets were neither decisively bull nor bear. Technically, they were successions of up and down secondary movements of but medium amplitude. At such times, the outsider courts disaster who has anything to do with the market.

One of the first and hardest things for the speculator to learn is, therefore, that he should wait for a bull or a bear market. It will come. Indeed, for years the market may be an alternation from one to the other. And when the character of the market is clear the speculator should take a position in consonance with the trend and stick to that position. Every bull market has its reactions, every bear market has its rallies. But the successful operator should stay a bull in a bull market and remain a bear in a bear market. To go against the main trend and attempt to catch reactions in a bull market (by short selling) or to go long for a rally in a bear market, is a source of confusion and almost certain loss.

When we say that a speculator should take a position, it is not meant that he should have a long account open when a break of large dimensions is imminent. But what is meant is, that he should not take the bear side. The reason is, that he is almost certain to invite mental confusion for himself; for he is extremely likely to begin to wonder whether the bull market is not over. We have already noted that bear markets do not follow on the first great bull peaks, but it is not so easy to remain sure of such facts, when one has out short lines.

WHIPSAWING

Occasionally, after a rise and a reaction, some particular stock which has been strongly bulled will go up again, then down again, and will keep on with this seesaw movement for perhaps some days in succession, when it will either come to a relative standstill or will again widen the limits of its swings. When the price is at one end of the swing, it seems to be sure to go still further. Frequently speculators buy here. The stock reverses its course and plunges downward. The speculator holds on a while, then sells out and waits. Swifter and swifter the stock goes down and finally the speculator can stand it no longer; he sells short. Promptly, the stock turns and goes up again; the speculator covers his short sale at a loss. Once more he is tempted, once more he is long and once more he finds he has bought just when the stock is about to plunge downwards. Movements of this sort over a range of ten or more points sometimes occur within an hour or two. The faster such a move, the more bewildering it becomes, till the speculator feels he is confronted with a marvel of devilish ingenuity. Indeed, his confusion may lead to serious personal losses.

Fortunately, this state of things does not happen frequently. But when it does, there is one and only one thing to be done: let it alone. Such movements cannot be anticipated, they cannot be trailed and they profit the pool involved only through the manager. In the Fall of 1915, Baldwin went through this sort of antics, and the same stock repeated something like the same performance after its recent great rise.

ACCUMULATION AND DISTRIBUTION

When a stock is being accumulated by an interested group preparatory to the spurt, it frequently, if not usually, moves for a short period between an upper and a lower limit, which may be quite narrow or may be five or six points or even more. The reason is almost obvious: the pool manager may have cleaned up the entire floating stock at a certain figure on some particular day. It is much wiser for him to wait and see if more comes to market. His abstention from the market and consequent withdrawal of purchasing support, lets the price sag to the point at which the specialist intends to support it (this latter price is only a little lower, if the pool buying has been skillfully conducted). Having decided that he can get no more stock at a given price, the manager may then throw some of his shares on the market in a lump or in a few lumps. By thus depressing the prices lightly, he intends and usually succeeds in shaking out some more shares. It will be observed that this process of accumulation requires not only skill but much patience. To get a line, let us say, of 25,000 shares, the manager may have bought and sold four times that much. But he must make sure that he has thoroughly cleaned up the floating supply, or the instant he puts up the price in earnest he will be confronted with a large mass of stock which he must either absorb or allow the market to break.

During the course of a distribution, a diagram of a stock's movements resembles greatly its movements during accumulation. It is at this point, one of the most

important practical points to a speculator, that charts, sad to say, do not give clear testimony. A seasoned speculator brought into the market on a sudden, and witnessing one of these long seesaws between limits would at once know that his problem was to determine whether the movement meant accumulation or distribution. The first thing he would do would be to inspect a graph of the recent history of the stock or to look over the figures in the last year or so. In a bull market he might not be able to decide merely on these data; for the same pool may repeat and re-repeat its operations if a bull market is in existence. The surest indication is to wait till the stock breaks out of its bounds one way or the other. If it goes up, it may be put down as next to certain that a rise is due, right then and there, and the stock is a buy on the spot. In the same way, if it breaks below the lower level, it will probably continue downwards.

There are, however, some complications here. It is plain that after a distribution, the stock can't go up, (unless, indeed, another pool has just stepped in). But, nevertheless, a real accumulation may be succeeded by a fall without a failure of the pool being implied. This is what may happen: the accumulation has been about completed but the general market has weakened. The syndicate manager judges it inexpedient to attempt to vend the line. Now, at such a juncture, he is quite aware that short selling will be applied to the stock. Unless, therefore, he intends a corner (a singularly rare process) he will, himself, let the price fall. Not only does he thus avoid having to absorb offerings at the highest prices then current but he may be able to

shake out the last remnants of stock held by some weak but previously hopeful owners. The only real difficulty which may confront the syndicate lies in its relations with its bank. If the bank is unfriendly or undependable, it may often be able to ruin a syndicate which has pretty much taken on its line but which has judged it wise to allow the price to sag for the time being. Of course, if a bank forces a syndicate to liquidate its loans, the stock will be thrown on the market and a severe collapse will ensue.

Sometimes, although the price may not fall after an accumulation, it may not advance. The pool judges the time inopportune. This, however, is rare. But a not infrequent situation calls for more detailed consideration. Sometimes a stock seems to go up by what may be called a series of "steps" or "strides." Accumulation occurs, distribution apparently follows, and yet the stock, after a rest, again advances and stops at a second apparent distribution level. It seems impossible to discern when the distribution begins and leaves off and when accumulation begins. Yet there is usually no real mystery. Pools, like every one else in the market, are actuated by just two motives. Hence, it happens at times that a pool has no sooner sold out than it is reconstituted and starts off afresh. It must be remembered that in Wall Street the enormous majority of business transactions are consummated by word of mouth only—no written instruments being required. Hence a speed in carrying out agreements, making and remaking them is effected which is astonishing to the commercial or industrial business man who wants things in writing. Also, it sometimes happens, when

a pool sells and finds the market ready to take all offerings, that it withdraws—the manager being certain that the market will absorb his shares at still higher prices. He may then decide to rebuy his former line in its entirety, or he may go on as things stand, feeling sure that those who have already bought from him will hold on for a while without offering back their shares.

CHARACTERISTICS OF THE SPURT

The above seems to be as far as it is wise to continue the analysis. A statement of further possible complications would only tend to confuse, and the main outlines have been sketched out sufficiently in detail not only to give to the student a good idea of what happens, but, it is believed, to be of real value to a speculator. We must, however, still note certain market appearances connected with the upward rush of the stock, the spurt, as it is called.

This happens after the accumulation is over. The price darts out of its boundary limits and shoots up. The manager is now bidding aggressively, his one object being to get the stock as high as possible before he meets serious offerings. It is a nerve-trying time, as everyone knows who has witnessed it. For if a miscalculation has been made, if some huge blocks are lurking but five or six points above the accumulation level, a sickening avalanche of selling may befall the pool. Moreover, even if no such hidden danger awaits the movement, great care must be taken if the stock is a dividend payer, not to put the price up too quickly. For, as already noted, real investment stock may come

to market. Further, if the stock goes up too fast, a crowd of public speculators may rush in and the speed quicken still more. A skyrocket performance may be imminent, sure to be followed by the investment selling we have just noted, as well as by the profit seekings of these same public speculators. In one instance of this sort, the writer saw the manager hurl block after block at the market to stop the furious upward movement he had himself started. (In this case, the movement was slowed down in time.)

The following point should be carefully noticed. When the stock darts upward, the volume of sales in the same time of trading should enlarge with the increase in speed. But if the speculator carefully notes the volume in comparison, not with his watch, but with the prices, he should find that this volume is not increasing—is diminishing for the transactions between, let us say, each point. To be technical but exact, the volume of sales increases with the time elapsed, but decreases per unit of price advance.

This indication is decisive that the upward move is on. But the speculator must buy at once. The spurt may be all over in an hour or two. Unless the stock is very well known and of very large capitalization, the quicker the spurt is over, the better for the pool. All they have to do now is to keep the price strong but well in hand and proceed to liquidate—the public being now sure that the stock is going very much higher. Double or treble tops are likely to mark the peaks of the movement. The liquidation by the pool is not always completed at the top. Sometimes the price is allowed to sag before the bag is empty and the remain-

ing shares are sold to the public as the price falls; it would seem as though the buyers here are those unfortunate chronic losers who believe in buying "on a scale down." In any event, it is certain that sometimes the distribution happens in part when the stock is sagging.

MARKET HANDICAPS

Before reverting to our main topic, that of profit taking, we have two or three minor but useful points to notice. A trader soon finds that he has against him about a point handicap for every trade, no matter how the market goes. First of all, he has his commission charges both ways, as was noted in the first chapter. If a stock sells over par, it will evidently cost a half point for buying and selling alone; indeed, if the stock sells above 200, this charge will be considerably higher. Then we must notice the interest charge. The broker habitually charges the customer a somewhat higher rate than he pays his bank. A charge of 6 per cent over long periods is not unlikely. Now, it has been urged by some writers that whether a speculator pay 4 per cent or 6 per cent can be of no real moment to him, as he is hoping for price changes much in excess of the difference in interest rates. But these writers forget to notice that when a trader pays, let us say, 6 per cent to a broker for funds and when his margin is, we may assume, 15 per cent—he is paying about 33 1/3 per cent on his own capital, or about half a point per month. Let us illustrate: If Jones is long at par of Southern Pacific on a 15 point margin, he has borrowed $8,500 of his broker's funds, and, at 6 per cent, pays $510 a

year or $42.50 a month. Now $510 is exactly 34 per cent on Jones's own capital of $1,500 and is about half a point each month on his 100 shares. Every point profit on these shares means $100, but every month nearly half of this sum will have to go for interest charges,—and this, even if the stock does not go up, or goes down. Evidently, even a 2 per cent rise affects materially a trader's possible returns.

To commissions and interest charges must be added the handicap of the "turn." In buying inactive stocks, this matter becomes of much more importance than either commissions or interest. The more active a stock is, the less important is this matter, but even in active stocks it may furnish a handicap of an eighth both when buying and when selling. The existence of the "turn" is due to the necessity of speeding the whole stock market up. The turn eliminates the otherwise inevitable haggling which would occur even in active stocks. At the close of the market the bid and asked prices in each security are printed on the tape. The difference between these prices is the amount of the turn at the close of that day. In practice, the turn means that a broker buying on a market order for a customer must take the offer of the lot he wants, at the first tender,—the asked price being invariably in an active stock fixed by custom and regulation at one-eighth in advance of the last sale. When a stock is very active and many brokers are crowded about the post on the floor of the Exchange, a broker buying for a customer may get his lot at a figure higher or lower than he had anticipated. Of course, he is allowed to bid before accepting the first offer and his bid may bring

out the shares he wants. But if not, he must take the shares at the offer price, provided, of course, that the order he is executing is given to him "at the market."

Even without allowance for the uncertain factor of the turn, the interest charges and commissions have a tendency to pile up which dismays the novice. Suppose a trader loses six times in succession, taking a loss of ¾ of a point each time, or 4½ points in all. If the stock sells between par and 200, his commissions have amounted to three points more. If the turn has been one-eighth against him each time, there is another point and half handicap to be reckoned. In other words, he has lost nine points in all and he may have made no real market error whatever.

CUTTING LOSSES

In the above example, the assumption has been made that the trader has learned to "cut losses"—get out as soon as he sees that the market is not going his way. But usually it is a long time before a trader learns to do this, his invariable tendency being to "see it through," which means he is either tied up for a long period or is shaken out as the stock continues to fall and finally reaches a point where his capital impairment forces him to relinquish his hold.

Taking all the above facts together, it is plain that a long commitment carried a month has against it from its very outset a handicap of over a point at the least. Now we shall see that 30 points net a year is about all a good speculator can hope for except in very bullish or bearish periods. It must be evident that a

succession even of quite small losses may prevent any real gains. Moreover, the idea that if the stock pays dividends, the dividends will take care of interest charges, while correct in theory is often erroneous in fact. For the dividend accrual which should extend over the entire dividend period often happens at the very end of the period and sometimes does not happen at all. The trader cannot be sure that the accrual will come to him at the right time, whereas the charges of interest against him are certain.

SOME PRACTICAL SUGGESTIONS

It would almost seem that we are here indicating that success to any outsider is utterly impossible, no matter what his qualifications. This would be an error. There is a way out of this ever present handicap of commissions and interest charges, but it is a way which brokers cannot be expected to recommend highly. The suggestion is this: take on the line gradually. Suppose a trader has up $15,000 as margin and has decided to trade in 500 share lots. Let him start by taking on one-fifth of his line, or only 100 shares. We assume that he believes the stock he buys is in an accumulation phase, and that he is waiting for the spurt. When the stock darts out, let him add to his line at once, buying on a scale up, keeping a stop order back of his purchases at some point chosen in accordance with the conditions of the movement (a broker can often here be of much use). If the movement is a fiasco, the trader has done right, he has "limited his losses." If his judgment proves correct and the stock advances, he is "letting

his profits run." This testing of the market by first buying an amount much less than the intended line, is nearly always to be recommended.

But it will not do to pass over the fact that here many traders will insist that they have found the trouble to be, that their convictions hardly ever agree with what the market does. When such is really the case, the wise speculator will decide that the stock market is not the best place for his capabilities. There are other traders who are able to cut their losses, but who seem never able to learn to take large profits. Hence they stay in the market year in and year out with little to show one way or another but experience. It need hardly be said that this sort of mental exercise is poor business: to justify an occupation with speculation, a trader cannot be content to know that he is not a lamb; unless he can win and win largely, the stock market is no place for a sensible man. And whether he can do so or not, depends, as we shall see in the next chapter, far more on temperament, or strictly personal psychological factors, than on any other factor whatsoever.

PROFIT TAKING

We may now at last discuss explicitly the question of profits. The trader must learn to take big profits, or it is utterly useless to be in the market. He must look to one profit more than to wipe out half a dozen little losses, made in testing the market. Let us make some preliminary suggestions. First, do not complicate your account. Do not have commitments open at the

same time on which diverse sorts of market action must be taken. Thus, do not have commitments open where in one stock you must think of closing, in another of taking a loss, in still another about stepping out. These complications interfere with one another's solutions, and, above all, they prevent or impede the trader from taking a single definite position and keeping it. The ordinary trader, the present writer believes, should confine himself strictly to one active stock or two stocks at the most. And, as most men are susceptible, more than anything else, to the blare of the customers' room,—keep out of it!

It must be plain by this time that the speculator in the market cannot bother with the little, or tertiary swings, and that he must not tie himself up for long periods. "Sitting-tight" on a stock, even if one's capital can stand it, for a year or so, is rather to be called "hoping" than "speculating." But the upward secondary swings of specific stocks in the market are the swings which the activities of pools create, and it is by getting in on a pool's move that the speculator has been here advised to act. Hence, in the last analysis, the objective of the independent public speculator should be to *trail the trend in a stock and liquidate when the group in control liquidates.*

STUDY OF THE GENERAL MARKET

It ought to be apparent by this time that the speculator's interest in the movement of the market as a whole is chiefly to enable him to judge whether general conditions are propitious for pool activity. As

already said, while the market moves as a unit, yet some stocks at a given time are moving briskly, others slowly, while still others are marking time. All pools obviously do not operate at the same time. Yet this is just what the speculator might be led to suppose who listened to advice, that he base his activities on general conditions. It seems a truism so flagrant that one hesitates to state it, that operations are necessarily in specific stocks and not in the general market. Mere study of the broad aspects of the market leads constantly to buying into stocks which are relatively quiescent and in which no pool is operating; and in stocks in such condition almost never can a speculator make money. For in such instances almost never is there any worth-while activity unless it is the forced activity of overdue liquidation.

FORECASTING

The foregoing remarks lead at once to the subject of forecasting. Many tables of correlations of business changes with market activities have been published—particularly in the last few years. What value have such tables? What value can they have? The instant the reader remembers that nothing happens in the market except through buying and selling, and that buying and selling depend on the human motives of fear and cupidity, he can discern the right method of approaching these problems. As long as a speculator or a group of speculators can make money in the stock market, they will stay in it, if they can, no matter what economic conditions may be. They will get out when

they see they have to get out—sometimes, not until they are actually forced out by banking pressure. The decision of successful speculative groups to desist from operations comes from their recognition of inevitable factors which will harm them if they continue their course; or, from the actual operation of these factors if they are obtuse (as they sometimes are). Hence, we may say that unless a business factor can be shown to affect the market through the supply of credit—through the banks—its usefulness is empirical, at the best. And a "forecaster," as these correlations are termed, which can offer no rational basis for its existence, is best let severely alone.

The accuracy of these remarks is best shown by reverting to the fact already noticed in the chapter on banking, that previous to the establishment of the Federal Reserve System, there were two indicia which pointed unmistakably to the advent either of a bull or a bear movement of large proportions. These two pointers were the relation of reserves to deposits, and the presence and extent of "surplus deposits" or "surplus loans." These indices said decisively either, "Here are funds ready for use in the market," or else, "No more funds available." There was nothing in any way mysterious about their operation. Henry Hall seems to have been the first to discern the significance of the latter of the two correlations. The significance of the first, the amount of surplus reserves, was discerned at all times. Had there been any large amount of literature on the market twenty to thirty years ago, the knowledge of these two easily read indices would possibly have affected to some noticeable degree, the na-

ture and time of public trading in the market. (An effective knowledge by the mass of public speculators of the essential factors of stock movements, would have a tendency to smooth out the market movements and bring about a variation in accordance with investment values.)

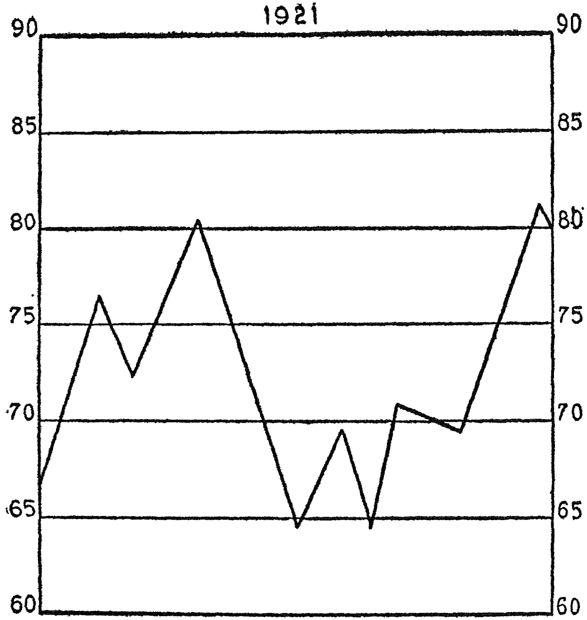
The predominant nature of directed control in the stock market is opposed by many students because it seems to make the market a vast gaming hall rather than a place where economic values are anticipated or reflected. The writer would be sorry to have such a view attributed to him. Facts, however, are facts, and the facts to be faced are that the reflection of economic values in the stock market is made by the tumultuous interaction of buying and selling originating in human fear and greed, not by the operation of "laws" in some misty way analogous to the laws of physical science. The ultimate purposes of the market, we must again repeat, are for control and for investment. Here we agree with all our prospective critics along this line of thought. But the character of the market is speculative, intensely speculative; and the dominant speculation is directed speculation. How anyone can be an observer of the vast market changes between 1924 and 1928 and still blink these facts seems, to the writer, at least, difficult to understand.

SOME RATIONAL CORRELATIONS

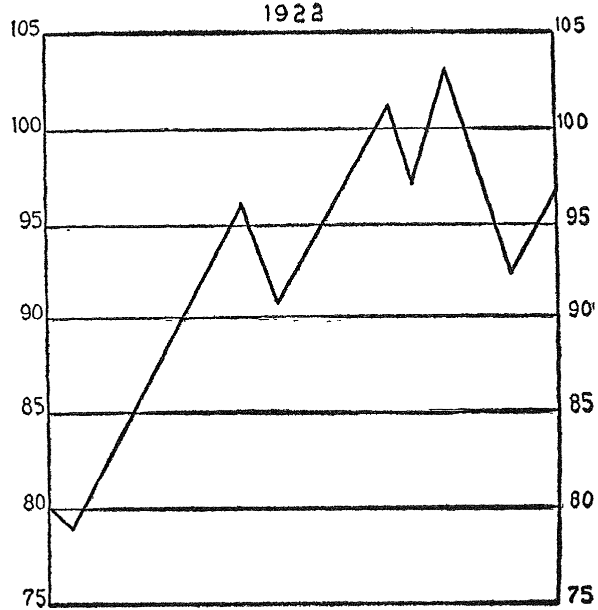
But, aside from forecasters, what a speculator may do, however, is this: first, in reference to a given stock, he may consider whether its value seems below its cur-

rent price. We have already indicated the limits to such "investigations." But at the advent of a bull market, there will be a general depression of prices below investment values, which is very significant. This first point shows that directed movements are favored by general conditions, and will have a certain reasonableness about them. The next question is, are such rises feasible? Here the single question is, the attitude of the banks; and this in turn depends on their supply of credit. Not only is this supply vastly in excess of that of former times, but should Congress ever remove the restriction on the rediscount by the Federal reserve banks, of loans on stocks and bonds, the credit supply will be almost illimitable. The removal of this restriction would put the operation of the Reserve System in this regard on a line with the practices of the European central banks. Such a step is desirable as it would leave the corrections of excesses in the market, to the market itself, and the banks directly concerned where it properly belongs.

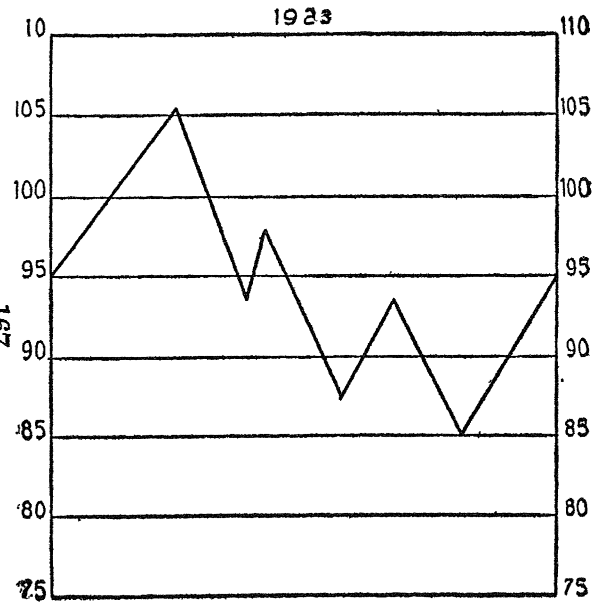
As a general rise proceeds, the public speculator can no longer depend on the index of depressed values. Indeed, he will begin to note that values generally are being submerged by prices, till finally it will be impossible for any one to doubt that prices are much too high for many stocks from an investment standpoint. Those financial experts who have specialized in investment work nearly always judge that rises are near their limit when this condition is at hand. Hence they chronically tend to underestimate the duration of the great bull markets. But, if the supply of credit keeps up, it is in the banks, and there only, that an efficient



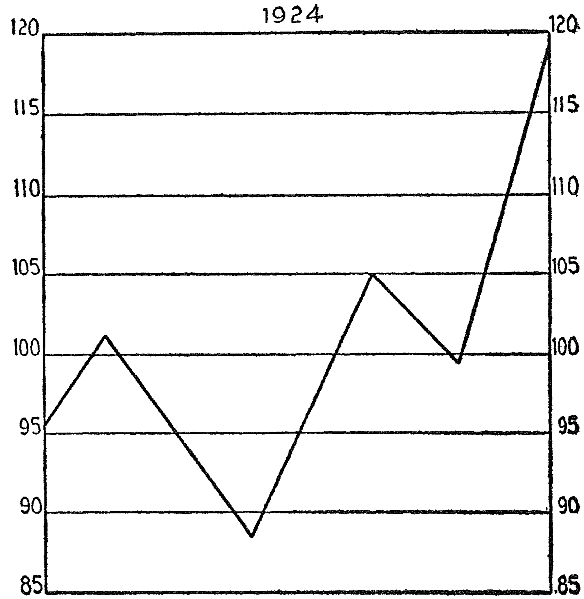
INDUSTRIAL AVERAGES, 1921



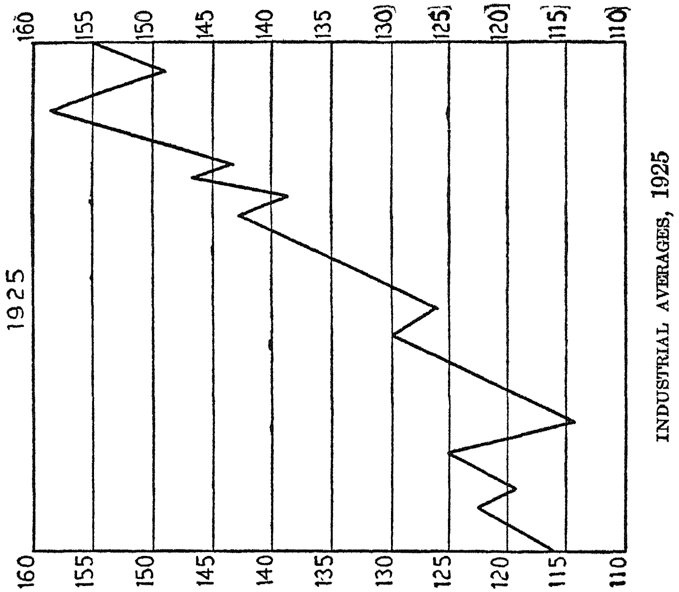
INDUSTRIAL AVERAGES, 1922



INDUSTRIAL AVERAGES, 1923



INDUSTRIAL AVERAGES, 1924

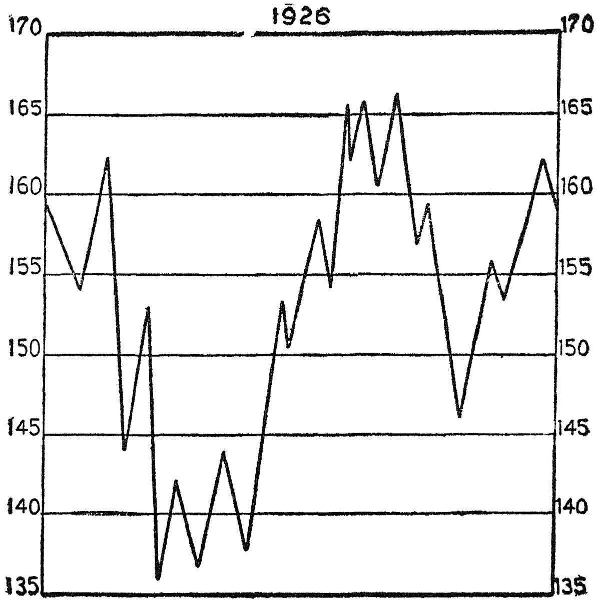


brake on the mounting side of speculation can be found. The first warning comes naturally in a smart rise in interest rates.

WHAT PROFITS MAY BE EXPECTED

We may now take up the questions of what may rationally be expected from the stock market by an intelligent man who has in some fair degree the qualities attending success in this profession. The charts here inserted should be of some use in determining this matter. They are of the course of twenty [1] representative industrials, known as the "Dow-Jones averages."

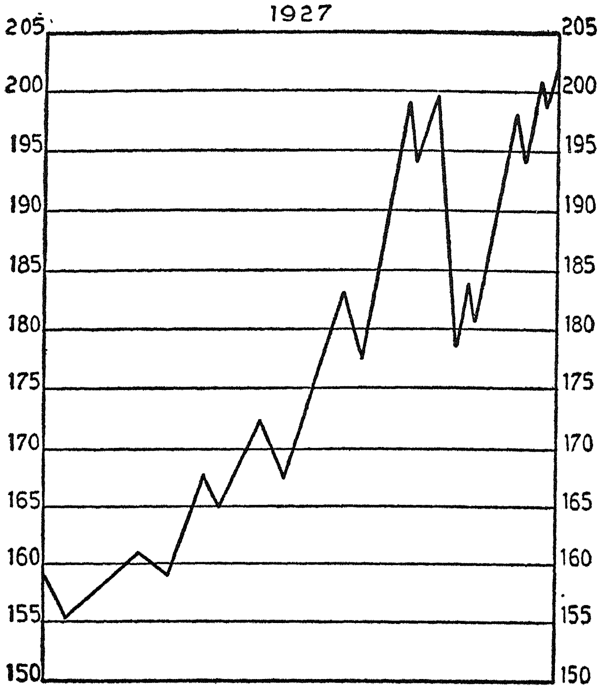
[1] Thirty, since the Fall of 1928.



INDUSTRIAL AVERAGES, 1926

During the period between 1920 and 1928, certain changes were made by the publishers to preserve the rationale of these charts. Thus, when a stock was split in four, the new price was multiplied by four, etc.

In the Fall of 1928, a divisor of 12.7 was applied to the prices of the twenty stocks, allowances for split-ups, etc., being thus obviated. Finally, in October, 1928, the number of stocks was raised to thirty with use of 16.67 as divisor. (See, on this matter, *Barron's*, Sept. 17, 1928, p. 16; and Oct. 1, 1928, p. 25.)



INDUSTRIAL AVERAGES, 1927

We will briefly consider each year from 1921 to 1927 inclusive. In 1921, the speculator had better have kept out of the market, as no position was clearly indicated, to be taken. But he might have been long in the latter part of that year when the rising averages crossed about 75, and he certainly should have been long early in 1922 when the averages broke through 80. For this latter year we may fairly give him a profit of 20 points. 1923 was a mild bear year; about 15 points on the down side may be allowed. In 1924, we

shall be conservative in allowing no more than 25 points gain. 40 points may be conservatively allowed in 1925; and in 1926, 40 points again (on the long side). In 1927, he might readily have made 50 points profit. On the basis of a 25 point margin, these profits mean, in 1922, 80 per cent on capital employed; in 1923, 60 per cent; 1924, 100 per cent; 1925, 160 per cent; 1926, 160 per cent; 1927, 200 per cent. In a similar study made years ago, based on the Dow-Jones railroad averages with a margin of 25 points, the profits were estimated as follows: 1905, 100 per cent; 1906, 160 per cent; 1907, 220 per cent; 1908, 120 per cent; 1909, 80 per cent. It would thus seem that if it is worthwhile to enter the market at all, 75 per cent profits may be reasonably worked for, and in definitely marked years, much larger profits are attainable. At the best, however, the figures show that the usual hopes of outsiders who enter the market will not be realized; for, such hopes frequently imply a profit of 100 per cent or more, a month. On the other hand, it will be noted that the successful speculator will learn to trade in a bear market. If he does not do this, he should keep utterly out of such a market (in the above calculations, what seems reasonable allowance has been made for the inevitable handicaps already mentioned).

The figures seem also to suggest about what should be the minimum capital employed in the market by anyone who intends to depend on speculation as a profession. But these conclusions can best be figured by each for himself.

CHAPTER XI

THE PSYCHOLOGY OF SPECULATION

It has been indicated both in the last chapter and generally throughout this book that the basic reason for the nonsuccess of the public in the stock market is the existence of personal traits among such participants which derogate from lucrative operations. We must now examine this point with some care. There are men with a really extensive knowledge of things financial who do not succeed and who never will succeed in stock speculation. Just why this is so, will, it is hoped, be made clear and definite, in the following discussion.

Let us start by noting, though of course in a necessarily general way, the personnel of the losers in the market. These losers make up what is now called the public and what used to be much less tactfully called the "lambs." In all the present writer's observation and from all his information, during many years in Wall Street, he has never seen a single consistent winner from among this group. The man who has the qualities which conduce to success in speculation, becomes, if he stays in the market, a close student and a semi-professional. He treats speculation as a business which is what the public do not do.

It hardly seems necessary to say that the public is not made up of the well-known "widows and orphans" as a certain type of politician and preacher often in-

sist. Although semi-professional operators among women are by no means unknown in Wall Street, it has not been customary among brokerage houses to accept women's speculative accounts. In the latter stages of the long bull market which closed in August, 1929, certain houses made exceptions to this practice; and some even opened separate customers' rooms for ladies. Even in such exceptional instances in this latter period, it does not appear that women have lost more seriously than men.

Nor is it true that men of the "orphan" or moron type appear largely among speculators. Previous to 1929, the writer had seen exactly one man clearly of that type in all his observations. Taking them all in all, the chronic losers in the market, despite the presence among them of many mean and cheap characters, do not seem inferior mentally to the usual successful business men. Often, losers are successful in their own business.

Classified by occupations, the doctor, the dentist and the real estate man are found frequently. So are all sorts of business men—merchants, jobbers and retailers. Quite frequent are those whose competence is derived from funds, inherited or previously acquired by personal capability outside of the stock market. There are also high salaried men to be found and, of course, from time to time, men lower in the salaried class pop in and out. But, generally speaking, the speculators in the stock market are men who are financially independent, no matter how small—even how extremely small in instances—may be the extent of the financial independence. These men come and go from year to year. Some are content with a short experience;

many are more or less chronic habitués of the market for active life. It is plain that without their own incomes, whether from profits, interest or rents or even from salaries, they could not afford their constant losses from year to year. Those actully ruined used to be few in number. The moron referred to above and a very fine old gentleman who shot himself through the head, are all the writer knows of with certainty in an experience extending over a period of some twenty years, until the débâcle of 1929.

It has sometimes been asserted that it is the noise and apparent confusion in a customers' room that causes ready losses. But not all customers' rooms are noisy nor even apparently confused. The speculator who deals with some habitude in lots aggregating 500 shares or more, can have all the quiet and orderly surroundings that he wishes. It is true that it would seem the speculator who deals in the market outside of New York City and who cannot watch the ticker from hour to hour, is less unsuccessful than his apparently better equipped co-speculator in Wall Street. The out-of-town man loses his money slower. The reason for his better mode of trading appears, to put it bluntly but truly, to be that he has less opportunity to make a fool of himself.

REAL VS. IMAGINARY TRADES

There is one fact which has been repeatedly noted which appears to give the best approach towards our problem. This fact is, that when an outsider of some intelligence transacts imaginary buying and selling operations in the stock market, he is much more likely to

show gains on his paper deals than when he is dealing in real stocks with real money of his own as margin. A questionnaire on this subject, well conducted, would afford an interesting revelation of the extent of the monetary difference between the real and the imaginary trades of speculators. But while no statistics can be given on this matter, the statement is undoubtedly true. Men who keep charts are often remarkable for the accuracy of their forecasts when out of the market and for their incapacity as soon as they have up their margin. Of course, the chart has no mysterious properties but merely serves as a good bird's eye reference as to what has previously happened in the market. The true difference then between success and nonsuccess in the market, in the instance of the public, seems to lie in certain personal differences in the same individuals when they are in and when they are out of the stock market.

The trained observer who, either as customers' man or as newspaperman in the financial department, has opportunity to watch, over rather long intervals, the coming and going faces in an active commission house, retains as probably his most definite impression the idea that these speculators are under a severe, carefully repressed nervous strain. It does not take much to snap this strain and show the intensity of the stress to which these men in various degrees are subject. On slight invitation, the reticent, suspicious New Yorker becomes not only sociable but definitely garrulous. Men who are in charge of the rooms often have cause to learn of this strain only too well. They know that sometimes an elsewhere dignified and reserved citizen will

babble fatuously of his private affairs. When the market is receding from the top or is very hesitant, these upset characteristics are sometimes painfully in evidence.

Under this strain, the usual speculator is careless, rash, over-trades and, in fact, is liable to commit most any technical error in the list. Yet it is not clear why this strain should necessarily lead rather to wrong than to right action. The ventures of the public in the market, are so rarely based and guided on sound reasoning that it is not easy to see why a nervous strain should be able to do them much harm. There must be some latent, deleterious trait which the strain brings into play, and it would seem that there is such a trait.

THE BASIC FACTOR OF PUBLIC LOSS

We have seen that to the observer the public speculator appears under a nervous strain. But, human nature being the same, this strain or, at the least, a tendency towards it, has probably been experienced at one time or another by everyone, public and professional alike, who has been in the market. Further, the strain may be felt without intermission even by the successful. Only, in their case, it does not lead to the mental state which is at the basis of the public's losses. For, in the last analysis, the public speculator when in the market is a bewildered man. His attitude towards the market can probably best be described as that of a man not yet fully awake. To use another simile, he is like a man in a broad street who loses his head in the midst of swift-moving motor cars. Or, as a man on the edge of

a cliff who wants to get away and who cannot. The man's personality is temporarily shaken or at least disturbed and he *acts in a condition of intense suggestibility.*

Now, the appearance of the stock market is, as has been several times noted, what has been well called "innately deceitful." It looks to the novice as though it were going much higher when it is really ready to decline. To this appearance and the ever continuing inroad of tips, when the time for tips is over, the public fall chronic victims. And from this combination of an ever-present untoward suggestion and of his over-suggestibility, the public speculator, no matter how lucky in his first commitments, eventually makes a great and disastrous blunder, or succession of blunders. Experience in the market teaches much, and the man, who, through the discipline of years, has become automatically immune to certain fool tactics, will lose his money slower than the novice. But, unless, when under severe strain, he is able to conquer his latent suggestibility, he simply cannot succeed in the stock market. It is but a corollary of this that it is much easier to handle successfully the funds of others in the market than one's own. The strain, the bewilderment, the consequent suggestibility, the succumbing to the obvious face of the market—all are abated.

We can now readily discern why the peculiarly senseless actions of the public at certain junctures. They fear when they should hope, and hope when they should fear. The public speculator with a profit sells too soon; he is afraid the market will turn and that he will lose his profit. He has ceased to have confidence,

if he ever had any, in his own judgment, to call the time for action. And when he buys and the market goes down, instead of fearing a large decline and therefore taking quickly a relatively small loss,—he hangs onto the stock and lets his losses run. Most curious of all, is his almost absolute inability to grasp and act on the fact that to buy cheap in the market and try to sell dear, is often to sell cheaper; and that to buy dear and sell dearer is quite often the right course of action. Indeed, when a speculator does buy at the right time in a rise, it seems as though even his acquisitive instincts arise to do battle against his best chances. For, in this case, it is hard for him not to over-speculate, pyramid and get sold out!

We need not press the psychological analysis further, though it seems that in certain individual speculators there are also definitely personal inhibitions making against success. Since speculation depends on the gambling instinct (though, itself, economically, not gambling) and since many men have been bred in youth to regard this spirit as noxious, it would sometimes appear that their confusion and maladroitness in the market spring from a sort of subconscious retributive reaction of their inbred convictions. But these are surmises which, true or not, need not detain us.

The attitude of general suggestibility implies a tendency towards collective action by public speculators in matters in which there is a collective general opinion afloat. Now most any one who has long observed the market and who has actually speculated over long periods will agree that, while the short side may not be the more lucrative to the professional, it is, in gen-

eral, alike to public and to professional, by far the safer. The data by which to call a fall are more explicit as a rule; the fall when it comes is quicker and so are the profits; and, if the market rises, it is usually much easier to get out of the commitment with small loss than if the commitment were an error on the long side. But professionals and semi-professionals see no good reason to become market instructors to the public, while those great interests which are habitually concerned with promotions, fiscal agencies and reorganizations, are naturally indisposed to recommend the short side to the generality of investors and speculators.

We may fittingly close this chapter by saying briefly that were it not for the broker, who often acts as a buffer to his customers from too egregious nonsense intended for their use, the general run of public losses might be greater and quicker than it is.

CHAPTER XII

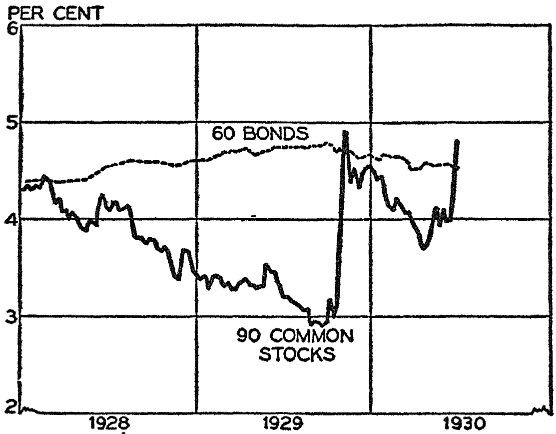
THE OLD MARKET AND THE NEW

No one who examines at all closely the American stock market can fail to perceive that in some important respects the market of to-day differs from the market before the war and especially from the market previous to 1910.

Perhaps the most obvious of these differences has to do with the rate of interest. Instead of the present stable rate, gently flowing in accordance with the rate on acceptances and with the somewhat higher rate on prime commercial paper and which keeps not far from the yield on good industrial bonds, we had, in the years comprising the first decade of the century, fluctuations of what would now seem incredible size. Between 1900 and 1910 the low call interest rates in summer, the high in Fall and the approximate percentage difference illustrate this fact:

Year	Low in Summer	High in Fall	Approximate Rise, Percentage
1900	2	25	1150
1901	4	10	150
1902	5	35	600
1903	3½	9	160
1904	1¼	4	220
1905	3	25	710
1906	6	40	570
1907	6	125	2000
1908	1¼	3	140
1909	2	6	200

Interest rates on call loans now arise in connection with the very special manner in which loans on active stock collateral are made through the Stock Clearing Corporation of the New York Stock Exchange. But while this arrangement (Meeker, Chapter XI, pp. 271-295) reduces the amount of credit borrowed during the day, it does not affect the amount of credit needed by brokers to carry the *balance* of the stock clearings. It has, however, resulted in the establishment of an immensely efficient system and since about 1922 the situation has been held closely in rein by a committee which at twenty minutes of ten o'clock each full business day announce their judgment of a fair rate for call loan renewals with the consent of the banking community (which is represented at the Stock Clearing House). The high interest rates in 1928 and 1929 are noted below.



AVERAGE DIVIDEND YIELD ON NINETY COMMON STOCKS COMPARED WITH YIELD ON SIXTY BONDS, 1928-1930 (STANDARD STATISTICS COMPANY FIGURES)

THE 1924-1929 MARKET

During the course of 1924-1929 market, the number of listed stocks rose till in 1928 there were over 1,100. Daily transactions, which in 1900 had been about 450,000 shares, and which in 1906 rose to a million, during 1925 and 1926 averaged about a million and a half. In 1927, two million share days were frequent, and in the last two years of the bull market five million share days became ordinary occurrences. (For an exact tabulation, see Frontispiece.) As the volume of shares grew, prices of seats shot up till they sold over the half million dollar mark, and it was found desirable to increase the membership by 25 per cent. In a general way, the diffusion of interest in stock speculation during these years may be traced by noting the extension of new offices both in and out of New York City. (See N. Y. Stock Exchange Year Book, 1928-1929.) An immense growth in trading on the New York Curb Exchange and on the various stock exchanges outside of New York further showed the broadness of the speculative interest. But exact figures on the most important points are largely lacking.

At the height of the boom, a truly extraordinary medley of human beings was in the market. Lower Broadway and Wall Street, at 3 P. M. each week-day, when the commission houses disgorge their occupants, presented a crowded mass of almost uniformly well-dressed speculators from every walk in life. A portion of this group came into the Street, beyond a doubt, because of the restrictions imposed in America on public gambling.

A curious psychological point was that the members

of these masses, differing from the oldtime speculators, had, nearly all of them, the singular notion that they were "investors," and that their purchases of stock for the rise were "investments." In fact, these words, before the end of the boom, almost supplanted the word "speculator" and its derivatives, to the amusement of the great bankers who brooded over the scene.[1] The frenzy was fed by some thirty-five advertising tipsters mostly in Boston and New York City who seem to have acquired an enormous clientele, and of whom exactly one appears to have had any real idea of market factors. The thirty-five unanimously called themselves "investment counsellors." The picture is completed by the inclusion of about half a dozen holders of chairs in the departments of economics of several Eastern universities, who extolled the excellencies of the market to the skies.

Turning to the more technical features of the period, we have first to note an alignment in speculative maneuvers of great industrial and commercial magnates hand in hand with financiers. On this matter we must dwell a moment, since it had a consequence which gives the real distinctiveness to the boom.

Up to the period of 1907 panic, the directed control in the New York stock market was enormously due to the presence of banking interests as market controllers, or at least as contestants by means of the Exchange for corporation advantages. The commitments of these men

[1] Purchases for appreciation are speculation by definition. But it is worth notice that the delusion on this point has not been confined to America. Writing after the Fall crash, a former M. P. observes that the British buyer of shares "does not really like to be called a speculator. He prefers 'capital appreciation' or 'investment for profit.'"

in single stocks were sometimes enormous and their activity extended throughout almost the entire twenty railroad shares of the old Dow-Jones averages—sometimes much beyond.

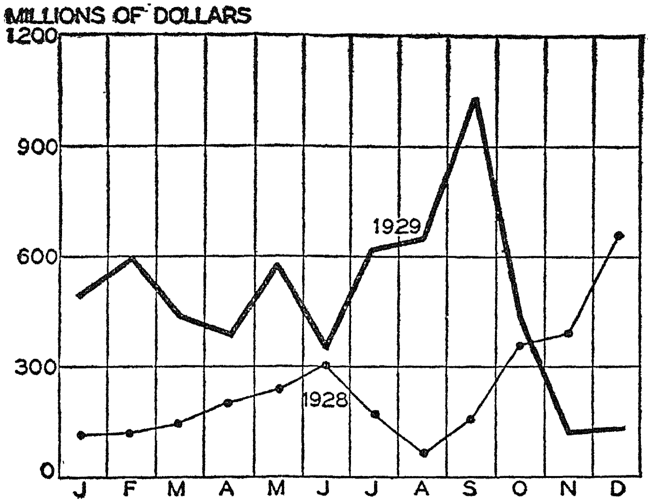
Between this group and the group of great industrialists and other business leaders there were not always close or friendly relations. Indeed, it was rather the contrary. The 1913 investigation by the Pujo committee had behind it some of the most powerful commercial and industrial magnates of America. How much feeling there actually was may be shown by the curious fact that some forty of the most important industrial and commercial capitalists in America were bondholders in the Kansas City, Mexico & Orient Road, an enterprise which had against it the practically unanimous pressure of the financial interests. No such divergence would now be likely.

NEW SECURITY OUTPUT

We may now note the distinctive feature of this new alignment. It was the enormous output of new corporate securities. Such securities were issued not merely for refunding and for corporate extension purposes, but for a purpose almost new in American financial history, namely, to finance current corporate expenditures of production and sale, thereby obviating to an immense degree the use of commercial paper and acceptances. The securities emitted for this purpose were very largely of the common stock type; and the period, not without good reason, has been called the common stock era.

From the beginning of 1924 to the end of 1929, the

total of American corporate securities issued (including governmental) was approximately 45 billions. While securities are taken up largely through the use of bank credit, yet new securities frequently can be absorbed only through the use of the buyers' own capital-credits.



ISSUES OF NEW STOCK BY DOMESTIC CORPORATIONS, 1929 COMPARED WITH 1928, COMMERCIAL AND FINANCIAL CHRONICLE FIGURES

Hence it would be desirable if there were some way in which the value of the net surplus wealth of the country could be gauged. Unfortunately, there is no agreement at all on this point. Estimates for recent years of a total gross income of about ninety billions of dollars [2]

[2] Mr. Fred I. Kent, director of the Bankers Trust Company, in an address before the American Acceptance Council, November 11, 1929, preferred smaller estimates—76 billions for 1928 and 78 billions for 1929. This is probably the most careful analysis published of the factors bringing about the crash of October-November, 1929. (See *Financial Chronicle,* Vol. 129, pp. 3268-3271.)

tell little or nothing as to how much of such funds find their way into security purchases. The immense expansion of security issues in the last two years of the bull market is shown in the diagram. Note especially the increase previous to the break. It is the situation of "undigested securities," which is so marked a feature at the beginning of great bear markets.

In connection with this method of providing for industrial and commercial needs by financial methods, two points deserve notice, first, the manner in which this new departure was made acceptable to prospective buyers of the securities, and, secondly, the influence of this new method upon security and upon commodity prices.

As regards the first point, a publicity campaign, at first disconnected and discontinuous, arose with the purpose of convincing prospective buyers of common stocks that such shares were as secure or nearly as secure as bonds, and that a diversified collection of such common stock was certain to appreciate in value in the future. Verbally, the appeal was to investors; actually it was to the type of buyer who wants both "a good buy and a sure thing."

THE "COMMON STOCK THEORY"

What might be called the rationalization of this movement was laid in two widely spoken-of, but, apparently, little read books. The former work, *Common Stocks as Long Term Investments*, by Edgar L. Smith, while not lacking in some interesting features, was hardly statistically conclusive. An attempt to supply this deficiency was made in a more elaborate work,

Investing in Purchasing Power by Kenneth S. Van Strum, with a foreword by Professor Irving Fisher. In this work the author undertook to generalize an attempted proof that ten common stocks chosen, with the largest amount of shares outstanding, compared well, both as to safety of principal and income, with a list of good bonds, over various periods not only when commodity prices were rising but when such prices were falling.

Taking Mr. Van Strum's lists it is obvious that his conclusions for the period of falling commodity prices have been obtained largely through the lucky chance that several stocks whose companies then held monopolies in different sections of the country were embraced in his choice, namely, Adams Express, American Express and Consolidated Gas of New York. For this same period about half of Mr. Van Strum's stocks are not really common stocks: they are single-class stocks. This distinction is of the first importance, for single-class stocks in the great American corporations have very largely been full paid from the start, whereas common stocks have almost always been largely water when issued. In a word, the conclusions drawn from Mr. Van Strum's shares are not at all applicable to the generality of common shares. (It is almost needless to say that the vast majority of American corporations have either failed or have gone quietly out of business.)

A more general contention in these two books and in the immense literature of pamphlets and newspaper articles supporting them was that in a country like America, assumed to be constantly growing, a corporation in a needed industry must be always secure, while

usually the major part of its earnings would accrue to its common stockholders. In other words, the argument was applied with equal facility to show that existing corporations would retain the cream of their business and that their new competitors would get it.

Adverting now to the influence of the vast output of securities upon stock and upon commodity prices it is obvious that it aligned the great industrial leaders solidly back of the bull market since only by marketing their shares could they obtain the funds they sought. There seems little doubt, strange as it may sound, that some industrial and commercial leaders actually came to believe the "common stock theory." The effect of the new method of raising corporate funds for current uses has been masked in relation to commodity prices by factors apparently of different tendency—mass production, "obsolescence" and installment selling. But however these and some minor factors actually interwove, the net total result was to hold up commodity prices and to inflate stock prices immensely.

But the most distinctive feature of the situation remains to be noted. Bank loans in business are normally the emission of bank credit for short periods on self-liquidating commercial paper. To finance the purchase of the new output of securities a vast emission of credit on their pledge was made; and as their prices enhanced, larger loans were made. Hence, a great inflation of bank credits in favor of the purchasers of stock.

INVESTMENT TRUSTS

The "new era," however, had other developments, of which one of the most important was the origination and

development of the so-called investment trusts. These concerns are essentially holding companies, sometimes of a fixed list of shares, sometimes with restrictions in their certificates of incorporation, or in their by-laws, as to the stocks in which they shall deal, but having mostly the character of speculative pools operating under the form of a corporation.

By May, 1927, about $300,000,000 had been put into about seventy of these concerns. By October, 1928, 207 were estimated to be in existence in United States and Canada, with total resources of over $1,000,000,000. (Nine of these trusts were controlled by four financial groups and accounted for over a half billion dollars.) By the end of October, 1929, about $1,400,000,000 was invested in these concerns, without taking into account new holding corporations, financing companies, etc. "Practically all of these trusts of real importance have been put out, or sponsored by or affiliated with groups emitting new issues of common and preferred stocks, very often of entirely new industrial or commercial corporations." [3]

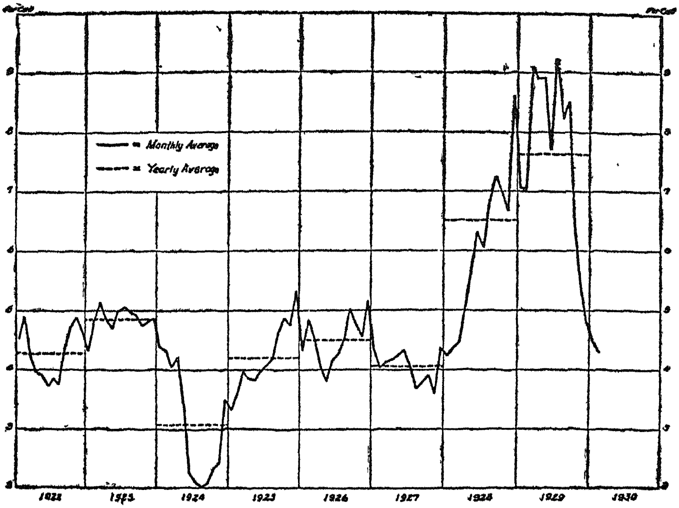
The period from about the close of May, 1928, until the end of the bull market was primarily a distribution period, during which the public took immense quantities of stocks at very high, at times almost incredibly high prices, from the hands of the market sponsors. A part of the distribution was effected indirectly through purchases by the investment trusts. These concerns, however, kept themselves, generally speaking, in a more liquid condition than might have been supposed, their

[3] "The Common Stock Racket," *North American Review,* April, 1929, p. 446.

managers having, with very good reason, much less confidence in themselves as professional stock market operators than had the public. A great deal of their financial undertakings confined itself to lending back into the stock market on call, the funds supplied by their subscribers.

INTEREST RATES

Beginning about midyear 1928 and continuing till the downfall in stock prices, very high interest rates pre-



MONTHLY AND YEARLY AVERAGE CALL LOAN RATES, 1922 TO 1930

vailed—the highest, in fact, over so long a period continuously, ever recorded on the New York Stock Exchange. These rates were not due to exactions by the banks, for bank loans by New York institutions or for

account of correspondent banks out of town varied relatively little in amount during the period. It was the loans by "others," rising as we have seen (see diagram, p. 195) from approximately one billion dollars at the beginning of 1928 to almost exactly four billions just previous to the crash, which were the determining influence in bringing about these abnormal interest rates. The lenders were private bankers, corporations, and investment trusts, which were, in effect, lending to the very pools in which they themselves or their allies were interested. Of course, the banking institutions also took advantage of these high rates when they obtained. Beyond a doubt, some of the more conservative banks hoped that these rates would act as a break on the speculative craze. But interest rates even averaging 9 per cent for a month at a time, pernicious though they might be to a bull in an ordinary rising market, will not control a runaway boom.[4] (See diagram, p. 190.)

Of an importance readily to be seen was the increasingly higher and higher margins demanded by brokers in the latter months of the market. These demands were enforced by pressure from the banks who had become exceedingly sceptical of the market. Even more important, however, as deterring a proper liquidation, was the Federal capital tax imposed on stock market gains. This

[4] Writers who assert that high interest rates do not deter trading for the rise in an ordinary market, are invariably without first hand knowledge of speculation, and very much overestimate the number of points likely to accrue to a successful bull. Further, they fail to realize that the actual interest charge against a speculator's capital (margin) represents a far higher rate than the interest rate nominally charged by the broker. To find the actual rate of charge, let this rate, X, equal $\frac{(p-m)i}{m}$, where p = price of stock, m = margin in dollars per share, and i = the nominal interest rate. (For an illustration, see p. 156.)

tax undoubtedly held many wealthy men in the market when their knowledge would, otherwise, have dictated sales. The importance of this matter may be seen from the fact that in New York State, the capital tax (state as well as Federal) would take away 28 per cent of stock profits, when levied against men of wealth.

THE CRASH

In this summary sketch, many points of interest must be barely referred to or passed over in silence. Only those matters of definitely causal importance can be here dwelt on. Thus, in a fuller account, the rises on European bourses concomitant, to a large extent, with the American boom would demand attention, while something would be said about the relations of the Federal Reserve Board and of the Second Federal Reserve Bank to the speculative situation. The crash was bound to come because when stocks reach vastly inflated prices, sooner or later the realization of the ridiculous return received on their holdings at current prices, strikes on real investors; and such holders, to a very large extent, sell to realize on the inflated prices payable for their shares. As banks judge the value of stock on exactly the same basis as does the investor, sooner or later, they put the brakes on wild rises. (See p. 20.) That many very powerful individual banking houses may have committed themselves to the inflation may defer the return to a normal condition, but it can only defer it. In the following paragraphs we shall therefore confine ourselves to a sketch of the factors which brought about the deflation as it actually occurred.

The beginning of a general decline was proceeded in August by the last great upshoot among the industrials. The Dow-Jones averages touched low for that month on August 9th and went to their record highest on September 3d. While not all the following prominent stocks made their topmost record on the latter date, it is convenient to give the prices for comparison as of a single date.

Name of Company	Low: August 9th	High: September 3
Allied Chemical and Dye	302¼	354½
American Can	156½	181⅞
American and Foreign Power	129	164¾
American Telephone and Telegraph	266	304
Anaconda Copper	114	131½
Bethlehem Steel	118⅛	140⅜
General Electric	365⅛	396¼
International Harvester	114¼	142
Johns-Manville	175⅛	207
Kennecott Copper	83⅝	92¾
Radio Corporation	79⅞	101
Standard Oil of New Jersey	56⅛	71⅞
United States Steel	213½	261¾
Westinghouse Electric	221	289⅞
Wright Aeronautical	116¾	136

Even while the August rise was in progress there appears to have been liquidation by English holders, and during September the market fell without a trace of worthwhile rally. The pools which had been manipulating the stocks mentioned, steadily liquidated. There was practically no short selling as yet,—the beating which the bears had received in the previous spring having made the most hopeful disinclined to short commitments.

During this September decline, stocks passed to an

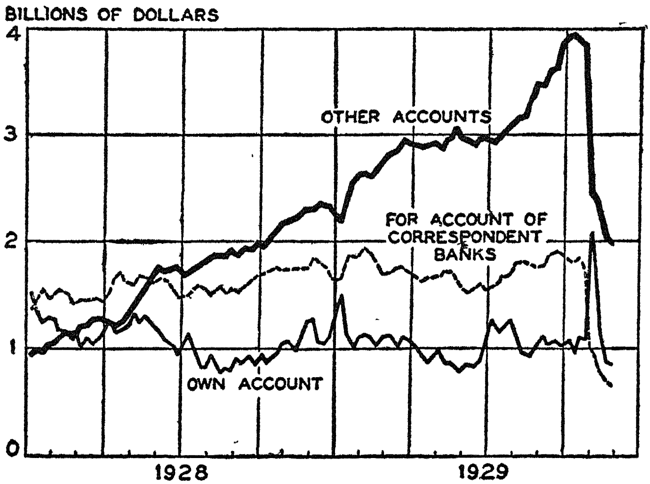
amazing degree into weak hands, as was shown by the rise of approximately half a billion dollars in brokers' loans between September 4th and October 2d. During the first three weeks of this latter month, the market exhibited most pronounced nervousness. (See p. 46.) These two features seem to have given the bears their cue, for short selling began to appear in this month. Indeed, towards the middle of October probably every professional, not entangled in bull commitments directly or indirectly, took a bearish attitude. The public, however, held on as long as they could. The first great break in the market was on October 24th and the sales of stock that day, eight million shares.

CALLING OF LOANS

The immediate cause of the downfall, both this day and on the succeeding Tuesday, October 29th, was the wholesale calling of loans by the much discussed "others," especially certain of the investment trusts. Between October 23d and October 30th, loans made by "others" fell 1,380 million dollars, and all or nearly all of this vast amount was undoubtedly called. The New York banks to a large degree stepped into the breach and their credits extended amounted to 992 millions. But the out-of-town banks also called loans right and left, and the net result for the short period mentioned, was that total brokers' loans fell from 6,634 millions to 5,538 millions, or a total net decrease of 1,096 millions. Undoubtedly, however, some customers' accounts thrown out by brokers (when the latter could not readily obtain banking accommodations in plenty)

were taken up by certain banks directly. Through this débâcle banks were more considerate of direct customers than of brokerage houses, and forbore to call loans against the former to a pronounced extent. Reports from outside of New York showed the same situation.

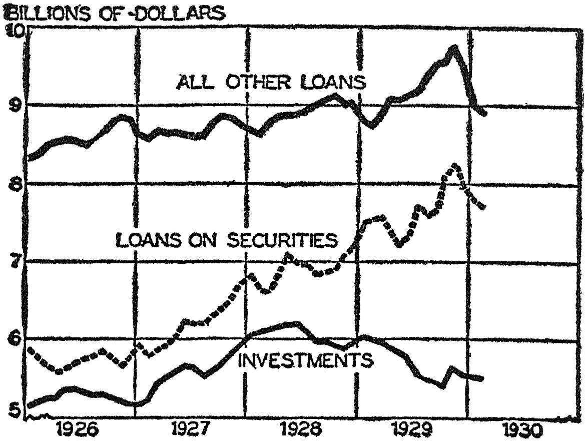
The chart below shows the loan situation in New York according to the Federal Reserve figures. The New



LOANS TO BROKERS AND DEALERS IN SECURITIES PLACED BY NEW YORK CITY BANKS FOR OWN ACCOUNT, FOR OUT-OF-TOWN BANKS, AND FOR OTHER LENDERS, 1928-1929

York Stock Exchange figures embrace reports for about half a billion more loans (see p. 68), but as the figures appear monthly only, they do not give so good an idea of the course of the October deflation. The figures are, however, subjoined (Table A). Total loans by all banking institutions throughout the country cannot be shown, as only the regularly reporting banks in the

Federal Reserve system separate loans on securities from other loans, and as the loans by State banks and trust companies combined probably account for something like half all security loans, no definite picture of the total fluctuations in security loans can be shown. Table B, however, shows the variations in all the



MONTHLY AVERAGES OF WEEKLY FIGURES FOR REPORTING MEMBER BANKS IN LEADING CITIES, 1926-1930 (LATEST FIGURES ARE AVERAGES OF FIRST TWO WEEKS OF FEBRUARY)

loans on which there are data. There is a slight overlapping in two of the columns, but this cannot be avoided. If these figures are a fair gauge, we must conclude that the vast deflation during October hardly touched the loans made directly by banks to customers.

THE CONSORTIUM

On October 24th a banking group, or consortium, was formed with a pool, as reported, of 240 million dol-

TABLE A

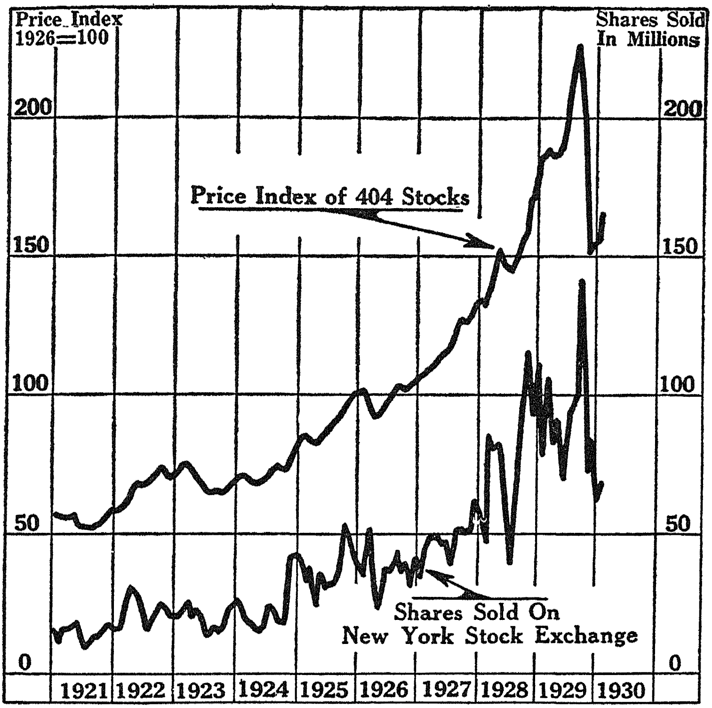
Compilations of the Stock Exchange Since the Issuance of Its Monthly Figures, Beginning in January 1926

	Demand Loans	*Time Loans*	*Total Loans*
1926			
Jan. 30......	$2,516,960,599	$ 966,213,555	$3,513,174,154
Feb. 27......	2,494,846,264	1,040,744,057	3,536,590,321
Mar. 31......	2,033,483,760	966,612,407	3,000,096,167
Apr. 30	1,969,869,852	865,848,657	2,835,718,509
May 28......	1,987,316,403	780,084,111	2,767,400,514
Jun. 30......	2,225,453,833	700,844,512	2,926,298,345
July 31......	2,282,976,720	714,782,807	2,996,759,527
Aug. 31......	2,363,861,382	778,286,686	3,142,148,068
Sep. 30......	2,419,206,724	799,730,286	3,218,937,010
Oct. 31......	2,289,430,450	821,746,475	3,111,176,925
Nov. 30......	2,329,536,550	799,625,125	3,129,161,675
Dec. 31......	2,541,682,885	751,178,370	3,292,860,253
1927			
Jan. 31	2,328,340,338	810,446,000	3,138,786,338
Feb. 28......	2,475,498,129	780,961,250	3,256,459,379
Mar. 31......	2,504,687,674	785,093,500	3,289,781,174
Apr. 30	2,541,305,897	799,903,950	3,341,209,847
May 31......	2,673,993,079	783,875,950	3,457,860,029
Jun. 30......	2,756,968,593	811,998,250	3,568,966,843
July 30	2,764,511,040	877,184,250	3,641,695,290
Aug. 31......	2,745,570,788	928,320,545	3,673,891,333
Sep. 30	3,107,674,325	896,953,245	3,914,627,570
Oct. 31......	3,023,238,874	922,898,500	3,946,137,374
Nov. 30......	3,134,027,003	957,809,300	4,091,836,303
Dec. 31......	3,480,779,821	952,127,500	4,432,907,321
1928			
Jan. 31......	3,392,873,281	1,027,479,260	4,420,352,541
Feb. 29......	3,294,378,654	1,028,200,260	4,322,578,914
Mar. 31......	3,580,425,172	1,059,749,000	4,640,174,172
Apr. 30......	3,738,937,599	1,168,845,000	4,907,782,599
May 31......	4,070,359,031	1,203,687,250	5,274,046,281
Jun. 30......	3,741,632,505	1,156,718,982	4,898,351,487
July 31......	3,767,694,495	1,069,653,084	4,837,347,579
Aug. 31......	4,093,889,293	957,548,112	5,051,437,405
Sep. 30......	4,689,551,974	824,087,711	5,513,639,685
Oct. 31......	5,115,727,534	763,993,528	5,879,721,062
Nov. 30......	5,614,388,360	777,255,904	6,391,644,264
Dec. 31......	5,722,258,724	717,481,787	6,439,740,511
1929			
Jan. 31......	5,982,672,411	752,491,831	6,735,164,241
Feb. 28......	5,948,149,410	730,396,507	6,678,545,917
Mar. 30	6,209,998,520	594,458,888	6,804,457,108
Apr. 30......	6,203,712,115	571,218,280	6,774,930,395
May 31......	6,099,920,475	565,217,450	6,665,137,925
Jun. 29......	6,444,459,079	626,762,195	7,071,221,275
July 31......	6,870,142,664	603,651,630	7,173,794,294
Aug. 31......	7,161,977,972	719,641,454	7,881,619,426
Sep. 30......	7,831,991,369	717,392,710	8,549,383,979
Oct. 31......	5,238,028,979	870,795,889	6,108,824,868
Nov. 30......	3,297,293,032	719,305,737	4,016,598,769
Dec. 31......	3,376,420,785	613,089,488	3,989,510,273

TABLE B

Minimum Known Total of Security Loans, with Separate Items of the Total (000,000 Omitted)

Month	Security loans (Rep. member banks)	Loans for "others" (F. R. B. brokers' loan figures)	Loans from "others" (N. Y. S. E. loan figures)	Total
1930				
Feb. 28	$7,641	$1,556	$639	$9,836
Jan. 31	7,667	1,648	616	9,931
1929				
Dec. 31	8,304	1,548	620	10,472
Nov. 30	7,889	1,982	585	10,456
Oct. 31	9,179	2,443	796	12,418
Sept. 30	7,826	3,907	1,472	13,205
Aug. 30	7,521	3,468	1,390	12,379
July 31	7,788	3,058	1,320	12,166
June 29	7,537	2,969	1,275	11,781
May 31	7,102	2,975	1,183	11,260
Apr. 30	7,386	2,876	1,194	11,456
Mar. 30	7,592	2,898	1,091	11,581
Feb. 28	7,573	2,724	1,060	11,357
Jan. 31	7,555	2,615	1,071	11,241
1928				
Dec. 31	7,230	2,166	1,039	10,435
Nov. 30	7,246	2,287	979	10,512
Oct. 31	6,958	2,154	886	9,998
Sept. 30	6,865	1,958	866	9,689
Aug. 30	6,740	1,907	791	9,438
July 31	6,954	1,833	687	9,474
June 30	6,888	1,729	730	9,347
May 31	7,097	1,642	706	9,445
Apr. 30	7,092	1,366	662	9,120
Mar. 30	6,675	1,278	693	8,646
Feb. 28	6,554	1,149	585	8,288
Jan. 31	6,769	1,052	615	8,436
1927				
Dec. 31	6,798	1,006	621	8,425
Nov. 30	6,585	964	573	8,122
Oct. 31	6,418	1,009	583	8,010
Sept. 30	6,457	918	575	7,950
Aug. 30	6,229	915	504	7,648
July 31	6,175	906	497	7,578
June 30	6,279	842	504	7,625
May 31	6,204	852	490	7,546
Apr. 30	5,978	804	476	7,258
Mar. 30	5,910	816	500	7,226
Feb. 28	5,858	821	499	7,178
Jan. 31	5,849	721	469	7,039



INDEX OF PRICES OF 404 STOCKS (COURTESY OF STANDARD STATISTICS COMPANY) AND VOLUME OF SALES ON THE NEW YORK STOCK EXCHANGE, 1921 TO 1930

lars at their disposal for the purpose of rendering the fall "orderly." The members of this pool were J. P. Morgan & Company, First National Bank, National City Bank, Chase National Bank, Guaranty Trust, Bankers Trust, and Guggenheim Brothers. As national banks may not buy common stocks for their own account it was explained that the buying for them was charged to their "security affiliates." Whether the 240 million dollars represented the face value of shares which could

be bought, or was merely a margin, was not made clear. It was more or less officially stated, later on, that only about half of the amount was used, but the precise meaning of this statement is unknown. The six banking houses represented in this group were the interests which had been most concerned in the boom.

THE PANIC

The largest fall came on Tuesday, October 29th, when sixteen million shares were dealt in. There was now a large short interest established, and this interest covered largely that afternoon and in the next two sessions. A horde of premature bargain hunters also appeared. The following day, the Exchange was closed until Monday, November 4th, and, after that, restrictions on trading were imposed by the Governors for several weeks. The culminating point of the decline was on Wednesday, November 13th, when the above named stocks made lows as follows:

Allied Chemical ($6 plus stock dividends)	197
American Can ($4)	86
American and Foreign Power	51
American Telephone and Telegraph ($9)	197¼
Anaconda Copper ($7)	70
Bethlehem Steel ($6)	78¼
General Electric ($4 and extras)	168⅛
International Harvester ($2.50)	65
Johns-Manville ($3)	90
Kennecott Copper ($5)	49⅜
Radio Corporation	28
Standard Oil of New Jersey ($2 and extras)	50
United States Steel ($7 and $1 extra in 1929)	150
Westinghouse Electric ($5)	102⅝
Wright Aeronautical	30

The figures within parentheses give the yearly dividend in dollars per share. Judged by income yield on the above prices, a few of these leaders were at reasonable prices. None, however, was a real bargain, with one exception. These figures are representative of the generality of shares: the lows on November 13th were still prices usually much above rational investment values, by the criterion on income yield.

Prices on this last day seemed for a short period about to undergo a very drastic further shrinkage. A general absence of buying power was in evidence. "The Stock Exchange on Wednesday looked like a bottomless pit," said *Barron's* truly in the issue of November 18th. This Wednesday, however, saw the low for 1929. The total deflation on all exchanges the country over has been estimated as in the neighborhood of 50 billion dollars. Prices rallied vigorously in early December, fell again to a low for the month on the 20th, and afterwards rose more slowly but more firmly in January-April.

COMPARISONS WITH FORMER BEAR MARKETS

Between the 1929 crash and preceding bear periods there are plainly some important differences. The ratio of the fall to previous falls is not important as certain factors have changed in the course of years which make comparisons of little value. But the bear markets of 1903, 1907, 1917, 1919-20 had one feature in common: they ran a very much longer time than a few months; and, at their bottom, investment yields were, in general, almost as much below fair valuations as they had previously been above. Also, the markets themselves, as far as can be now determined, were very thoroughly liqui-

dated. (Indeed, these last two features are two ways of looking at the same set of facts.)

The above facts have led naturally to the view that the two post-November rises just mentioned are best regarded as incidents in a primary bear market. Nevertheless the vigorous bull interim of January-April calls for explanation. In a bear market, how is such a counter-movement, so extended and far-reaching, possible? The answer appears to be that the vast mob suggestion of the common stock theory has to a large extent persisted, while, in addition, there is no doubt that very powerful interests had been left with stock which they had bought at higher figures and which they have had no desire to vend at lower prices. (The course of the consortium referred to above is in line with this; but this group, as far as can be judged from their public utterances, finally closed out in February.)

In the bull market of 1924-29 and in the succeeding bear market of September, 1929, onwards, we face the fact that the mass speculative judgment of the participating public, no matter how wealthy its members in individual cases, has been the judgment of the ill-informed to a degree unknown in previous years in the American stock market. It is the realization of this error in judgment on the part of very many stockholders which is an important factor in maintaining in 1930 the steady, persistent ooze of liquidation arising from other than necessitated selling.

The February-April bull movement came to an end in the latter month and the ensuing fall went well into June, the Dow-Jones industrial averages on June 24, 1930, being but thirteen points above the low on

November 13, 1929. A rally developed in the following weeks (July 16, 1930).

CONCLUSION

While it may be true that the financial importance of the New York Stock Exchange has not grown to the extent which might be suggested by statistics of other business activities and of the population's increase in numbers and in wealth,—yet the growth, absolutely if not relatively speaking, has been nearly twofold since 1906 on the most conservative mode of estimate. Moreover, if we press the apparent parallel of the market from 1924 onwards to the market of 1898 to 1902, the conclusion would seem to be that we are entering a period where the speculative markets will exercise their functions on a scale immensely larger than on the average exhibited in the score of years following 1906. We seem to be in for a revival on a scale of magnitude very much larger indeed of the great speculative years in the first decade of the century.

A word should be added as to the present-day function of the American stock market, especially as localized on the New York Stock Exchange. Its historic use in the distribution of American securities has not lessened in value, while it is now a necessity for the effectuation of American placements into foreign government issues, foreign industrial enterprises and foreign commercial business. Without its intermediation and listing, immense investment, as well as semi-speculative funds would be withheld. The American stock market is a necessity for the maintenance and extension of American financial hegemony throughout the world.

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